CHAPTER 4: FINANCIAL MANAGEMENT

4.1 INTRODUCTION

Successful projects require sound financial management procedures to track funds, prepare realistic budgets, manage project funds effectively, and report financial progress. This chapter covers the borrower's financial management responsibilities and provides guidance to Loan Servicers on monitoring a borrower's financial management performance.

The chapter is divided into five sections. Section 1 describes program requirements and Agency monitoring responsibilities for the project accounting system. Section 2 discusses the contribution, use, and monitoring of Initial Operating Capital. Section 3 outlines the requirements for and monitoring of reserve accounts. Section 4 explains project budget requirements and the budget approval process. Section 5 describes project reporting and financial examinations and Agency review of these reports.

SECTION 1: PROJECT ACCOUNTING SYSTEM

4.2 OVERVIEW OF ACCOUNTING SYSTEM REQUIREMENTS *[7 CFR 3560.302]*

Borrowers must establish accounting systems that support safe and sound project financial management. The accounting system must allow borrowers to track the use of funds, report accurate operational results to the Agency, and otherwise comply with the terms of their loan agreement. The following requirements apply to the borrower's accounting system:

- **Agency approval.** The accounting system must be approved by the Agency as part of the management plan (as discussed in Chapter 3). The borrower must notify the Agency of any changes in the method or system of accounting through a revision to the project management plan.

- **Method of accounting.** The borrower may use a cash, accrual, or modified accrual method of accounting, as long as the method is consistent with the statements required by the engagement in accordance with this chapter.

- **Recordkeeping.** Borrowers must retain all financial records and supporting material for at least 3 years after the issuance of annual financial reports and financial statements. These records must be maintained in a manner that can be audited by the Agency or a third party. The Agency may request that these materials be made available if needed to examine the project's finances.

- **Account requirements.** The following general requirements apply to the borrower's accounts:

  ◊ Accounts must be in domestic institutions;

  - ◊ Accounts must be insured by an agency of the Federal Government, backed by collateral proved by the bank, or held in securities meeting the requirements of 7 CFR part 3560, subpart G; and

  - ◊ Borrowers must maintain at least one demand deposit or checking account (so that funds are always readily available to pay necessary operating expenses).

- **Use of funds.** Funds must be held in trust by the borrower until used and serve as security for the Agency grant or loan (except for funds in the security deposit/membership fee or patron capital accounts).

  - ◊ In no case may project funds be pledged as collateral for nonproject debts; and

  - ◊ Funds must be used only for authorized purposes as described in 7 CFR part 3560, subpart G and the project loan agreement or resolution.

- **Separate accountability.** The accounting system must establish separate accountability for different projects. In other words, the borrower may combine funds from different projects owned by the same borrower with the same tax identification number or Social Security Number in the same bank account, as long as the accounting system segregates and tracks each project's funds separately. The management plan must document how revenue and expenses that are not clearly associated with a particular project are prorated across projects. (For example, the plan must document how costs for a computer system that serves several projects are allocated across the projects.) The accounting system must track these prorated costs.

4.3 OVERVIEW OF ACCOUNTS

The borrowers must establish and maintain the accounts required by their loan agreement or resolution. At a minimum, these include the following accounts:

- General operating account;

- Tax and insurance account (if the amounts escrowed are not part of the general operating account);

- Reserve account;

- Security deposit or membership fee account (if applicable); and

- For cooperative projects, a patron capital account.

Each account serves a different purpose, as described in the following paragraphs.

A. General Operating Account

The borrower must establish a general operating account to handle all revenues and expenses associated with project operations. Authorized expenses payable from this account include expenses that are directly attributable to project operations and are necessary to carry out successful project operations. For a full list of acceptable expenses, see **Attachment 4-A**.

In addition, the borrower is required to deposit in the general operating account a minimum of 2 percent of the total project development costs. These funds must be deposited at loan closing or start of construction (whichever occurs first). This Initial Operating Capital is to be used for initial operating expenses, such as advertising, insurance, fidelity coverage, and initial lease-up expenses. The funds may also be used to meet project obligations, such as debt payments and reserve deposits, until cash flow is sufficient to fund these accounts.

Between the project's second and seventh year, borrowers may request that these funds be returned if the project is showing sufficient cash flow to cover all obligations, including funding the reserves. Withdrawals may be made in a lump sum or in annual increments between the second and seventh year. More detail on Initial Operating Capital is provided in Section 2 of this chapter.

The general operating account will be deemed to contain surplus funds when the balance at the end of the housing project's fiscal year, after all payables, exceeds 20 percent of the operating and maintenance expenses. If the borrower is escrowing taxes and insurance premiums, the calculation should include the amount that should be escrowed by year end and should subtract taxes and insurance premiums from operating and maintenance expenses used to calculate 20 percent of the operating and maintenance expenses.

If the general operating account has surplus funds at the end of the housing project's fiscal year, the Agency will require the borrower to use the surplus funds to address capital needs, make a deposit into the in the housing project's reserve account, reduce the debt service on the borrower's loan, or reduce rents in the following year.

B. Tax and Insurance Account

The borrower must deposit money, on a monthly basis, to pay required taxes and insurance. Generally, these funds can be kept in the general operating account, as long as they are tracked separately from other general operating funds to ensure that funds are available to pay taxes and insurance. In some cases, however, the Agency may require a separate account for taxes and insurance to ensure the availability of these funds. See Chapter 3 for a discussion of insurance requirements and taxes.

C. Reserve Account

The reserve account is funded through contributions from project operating funds. It is used primarily to pay for large planned expenses for maintenance and improvements of capital items. The project's reserves must be held in a supervised account that requires the Agency's countersignature on all withdrawals. The administration of project reserves is covered in detail in Section 3 of this chapter.

D. Security Deposit or Membership Fee Account

The security deposit or membership fee account holds funds provided by residents as security deposits and membership fees. See Chapter 7 for a full discussion of security deposits and membership fees.

- **Uses of funds.** Funds deposited in the security deposit/membership fee account must be used for purposes outlined in the management plan:

  ◊ The borrower may only use security deposits to cover costs of fixing damage to unit beyond ordinary wear and tear by the tenant who provided the deposit. The funds must be returned to the tenant if not used. If the borrower cannot locate tenant to return the deposit, these funds must be deposited in the general operating account or handled in accordance with applicable state laws. In cooperatives, the return of membership fees depends upon the legal instruments governing the project.

  ◊ Funds retained by the borrower as a result of a lease or occupancy violation must be transferred to the general operating account and treated as project income.

- **Interest.** The interest on security deposit/membership fee accounts is handled in accordance with state law. If no state law governs the use of interest, it must be deposited in the general operating account, at least once annually, and used for general operating expenses. In no case may interest accrue to the benefit of the borrower or management agent.

E. Patron Capital Account

In cooperative projects, borrowers must establish a patron capital account to hold excess operating funds in trust for cooperative members.

- Any funds in excess of 3 months of average operating expenses remaining in the general operating account at the end of the fiscal year must be deposited in the patron capital account. This account must be interest bearing and must be administrated according to state laws governing patronage capital.

- Each member of the cooperative must be assigned an equal portion of the funds in this account. These funds are held in trust for the members of the cooperative until they terminate their membership in the cooperative. Members may receive their portion of the funds only if they have paid all membership charges and costs due the cooperative.

4.4 MONITORING THE ACCOUNTING SYSTEM

Loan Servicers must monitor project accounting systems to ensure that proper accounts are established and that these accounts are maintained in accordance with program requirements and the project’s loan agreement/resolution.

The six specific circumstances when Loan Servicers must review a project's accounting system and project accounts are discussed below.

A. Review of the Management Plan

When examining a borrower's management plan for a project, Loan Servicers must review the description of the accounting system to ensure that it addresses the requirements listed in Paragraphs 4.2 and 4.3. In particular, Loan Servicers must ensure that:

- The system ensures separate accountability—it allows for separate tracking of funds for different projects owned by the same entity; and
- The system handles interest correctly and in a manner consistent with state law.

For a full discussion of the review of the management plan, refer to Chapter 3.

B. Pre-Occupancy Meeting

The pre-occupancy meeting is held before the project begins the lease-up process. It represents a chance for the Loan Servicer to explain program requirements, including accounting requirements, to the borrower. In particular, the Loan Servicer should describe the accounts that must be established, acceptable accounting methods and institutions, and the need for separate accountability. If the borrower has already established the accounts, the Loan Servicer should examine statements from the financial institution to ensure that all appropriate accounts were established. (For a full discussion of the pre-occupancy meeting, see Chapter 8 of HB-1-3560.)

C. Post-Occupancy Visit

As part of the post-occupancy visit, the Loan Servicer must confirm that the borrower has established the appropriate accounts and is making the required deposits. The Loan Servicer must examine the borrower's bank statements to ensure that accounts were established and that they were established in a proper institution with proper insurance. The procedures for this visit are described in Chapter 8 of HB-1-3560.

D. Quarterly and Monthly Reports

Quarterly and monthly reports provide an opportunity to check on the status of project accounts of new and troubled projects on a regular basis. The Agency does not expressly require submission of these reports except from projects during their first 12 months of operation or from troubled projects. When reviewing these reports, Loan Servicers must verify account information and take the following actions:

- Confirm that the account balances provided on the reports are appropriate. For example:

  ◊ Are the reserves reported at the appropriate level as specified in the loan agreement/resolution?

  ◊ Does the balance in the security deposit/membership account appear appropriate for the number of tenants and the amount required for deposits/fees?

  ◊ Does the tax and insurance escrow reflect appropriate monthly deposits and appropriate withdrawals? (Taxes may be due monthly, quarterly, biannually, or annually.)

  ◊ Have there been any dramatic, unexplained changes in the general operating account?

- Confirm that the funds are deposited in accounts that are backed by either of the following:

  ◊ Federal Deposit Insurance Corporation (FDIC) insurance coverage;

  ◊ Collateral pledges of amounts above FDIC limits; or

  ◊ Other coverage against theft or dishonesty.

E. Budget Review

During the review of the budget, Loan Servicers must evaluate the borrower's plans for funding, maintaining, and using the accounts to determine if the budget is realistic and reasonable. See Paragraph 4.18 for more information.

F. Annual Financial Reports

The review of the annual financial reports provides the most detailed information on the status of project accounts. The annual financial report looks specifically at the accounting system to confirm that the required accounts are properly maintained and tracked separately. The annual financial report also looks at each account to make sure that deposits and withdrawals comply with programs rules—that funds were expended for proper purposes and all required payments and deposits were made. In reviewing the annual financial report, the Loan Servicer is able to obtain information about the financial stability of the project. If the report indicates that there is a negative trend in the project's finance, this alerts the Loan Servicer to review project operations more closely.

SECTION 2: INITIAL OPERATING CAPITAL AND BORROWER RETURN ON INVESTMENT *[7 CFR 3560.304 and 7 CFR 3560.305]*

4.5 INTRODUCTION

This section is about a fund, known as Initial Operating Capital, which the Agency requires to protect the security of the project during its initial years.

4.6 PURPOSE

The period between initial occupancy and full rent-up in a project can be risky because rental income may not be sufficient to cover all operating costs, make payments on the Agency loan, and make required contributions to the reserve fund. In addition to these regular operating expenses, there are some special expenses associated with this period, such as purchasing furniture or equipment for public spaces or advertising and marketing. To assist projects through this phase, the Agency requires the establishment of a fund for Initial Operating Capital.

4.7 CAPITALIZATION OF INITIAL OPERATING CAPITAL

All borrowers must provide Initial Operating Capital equal to at least 2 percent of the loan amount to support initial operation of the project. Limited-profit borrowers must put this amount down at the loan closing or construction start, whichever comes first. The Agency may loan the required 2 percent to not-for-profit borrowers. (For details on this process, see HB-1-3560.) Borrowers provide the Agency with a list of proposed uses for Initial Operating Capital during loan origination.

4.8 ACCOUNTING FOR INITIAL OPERATING CAPITAL AND OTHER ADVANCES

A. Initial Operating Capital

When the project accounts are established, Initial Operating Capital is blended with other revenue and used for operating expenses.

The borrower may leave an amount of money equal to the initial capitalization of the fund in the operating account. This money should not be treated as excess funds in the operating account nor should it be transferred to reserves. In addition, its presence in the operating account should not be used as justification to deny a rent increase.

B. Other Borrower Advances

Prior written approval by the Loan Servicer is required for any advances made by the borrower, borrower entity, or designee to cover ordinary project operating expenses. Such advances may be authorized when justified by unusual short-term conditions. When conditions are not short term in nature, a servicing plan may be developed and advances may be approved if justified by the following:

- A review of the documented circumstances and the project operating budget before any funds are advanced. The financial position of the project must not be jeopardized.

- Funds are not immediately available from any of the following sources:

  ◊ Reserve funds;

  ◊ Initial operating capital; or

  ◊ An imminent rent increase.

Interest may be charged or paid on the loan from project income; however, interest must be reasonable. The proposal may be denied if Agency financing can be provided to resolve the problem in a more cost-effective manner.

No lien in connection with the loan will be filed against the property securing the Agency's loan or against project income. The advance may show as an unsecured project liability on financial statements prepared for year-end reports until such time as it is authorized to be repaid.

4.9 DURATION OF INITIAL OCCUPANCY

The initial occupancy phase lasts until the project has attained a stable occupancy rate and the operating budget can reliably be supported by rental income. Projects vary as to when they achieve this stability; the Agency anticipates its occurring sometime between the end of the second and seventh year of occupancy. At that point, a for-profit borrower whose cash contribution created the Initial Operating Capital may request that the contribution be repaid.

4.10 REPAYMENT

A. Agency Policy

The borrower may, with the consent of the Agency, withdraw its original contribution to the Initial Operating Capital in multiple annual installments or a single installment between the second and seventh full year of project operation, provided the borrower can satisfy Agency criteria for approving repayment. Repayment can only be made once the project has been operating for 2 years and the project's operations and finances have stabilized. Repayment must be made during the initial operating phase, which ends at the close of year seven. Repayments may be in one to five installments, until the borrower's contribution to Initial Operating Capital has been fully repaid. The financial condition of the project may preclude full repayment of Initial Operating Capital.

The borrower must be able to demonstrate that the project is financially stable, that repayment will not require a rent increase, and that the project is in compliance with Agency requirements.

B. Borrower Submissions

- The borrower may submit a request for repayment of Initial Operating Capital with the transmission of the annual financial report.

- The borrower’s request is submitted in writing and addressed to the Servicing Office.

- The submission includes documentation demonstrating how the project meets Agency criteria for repayment:

  ◊ The project’s financial position is stable (e.g. no accounts payables);

  ◊ The project has averaged 90 percent occupancy over the most recent 12 months;

  ◊ Contributions to reserves are on schedule;

  ◊ There are no outstanding compliance violations;

  ◊ The project is not under a workout agreement; and

  ◊ Repayment will not require a rent increase.

- The submission should specify the amount of the repayment the borrower is requesting in the current year, and, if applicable, the borrower’s plan for completing repayments in ensuing years.

C. Agency Processing

Staff examine the submission for eligibility, completeness, and compliance with the criteria the Agency has established that a project must meet in order for a repayment to be made. If staff find that the project can support the repayment, an additional analysis is performed to compute the amount.

Staff may approve requests for the repayment of Initial Operating Capital only if the borrower’s written request and the Agency’s records demonstrate the following criteria:

- **Occupancy.** The occupancy rate for the project over the most recent 12 months has averaged 90 percent.

- **Contributions to reserves.** Contributions to reserves are on schedule, less any authorized withdrawals.

- **Sufficient income.** When the amount of the repayment is subtracted from the general operating account the ending cash balance still includes an amount equal to 10 percent of projected annual operating costs, and all required payments for taxes and insurance.

Impact on rents:

◊ Repayment is denied if it creates a shortfall in operating income that must be made up by a rent increase.

◊ There is no issue if no rent increases are projected in the year the repayment is made.

◊ A rent increase will not affect repayment if rents are increasing to cover increases in costs, such as wages, taxes, or insurance.

1. Amount of Repayment

The borrower may receive an amount equal to the original contribution of Initial Operating Capital or a smaller installment if the operating budget cannot support repayment in a single installment (see examples).

Example			
	Case One	Case Two	Case Three
Year-end cash balance	$57,000	$40,000	$27,000
10% O&M requirement plus taxes and insurance	27,000	27,000	27,000
Initial Operating Capital	30,000	30,000	20,000
Repayment Amount	30,000	13,000	30,000
Initial Operating Capital unpaid balance	0	17,000	30,000
The borrower in Case One can be repaid in a single installment. The borrower in Case Two would require three installments, assuming little change in the project's financial condition. The borrower in Case Three could not receive any repayment this year.			

2. The Decision Process

- The Servicing Office has 60 calendar days to review the annual financial statement, including the request for repayment of Initial Operating Capital.

- The Servicing Office may decide to:

  ◊ Permit repayment in the amount requested by the borrower;

  ◊ Permit repayment, but in an amount less than that requested by the borrower; or

  ◊ Refuse repayment because the project does not meet the criteria for repayment.

- The decision of the Servicing Office is transmitted in a letter to the borrower. In addition to the amount, if any, of the authorized repayment, and/or the reasons for denying repayment, the letter states the amount of any remaining unpaid balance of the original contribution to Initial Operating Capital.

- Multi-Family Information System (MFIS) is updated to show the amount of the authorized repayment and the unpaid balance of Initial Operating Capital.

D. Repayment of Advanced Loan Funds

The payback of the advance may be permitted by the Loan Servicer, provided the terms and conditions were mutually agreed to by the borrower and the Agency at the time of the advance and the financial position of the project will not be jeopardized. Payback should only be permitted on the advance when the Agency debt is current and the reserve requirements are being maintained in accordance with Section 3.

4.11 RETURN ON INVESTMENT

The borrower may take the return on investment (ROI) before withdrawing the original contribution to Initial Operating Capital. Borrowers may receive a ROI in accordance with the terms of their loan agreement and the following:

- The borrower may take the ROI after the project's fiscal year ends if there is a positive net cash flow (see line 30 on *Form RD 3560-7*) and the balance of the reserve account is equal to or greater than required deposits minus authorized withdrawals. If the annual financial reports indicate that the borrower should not have taken an ROI, the Agency will require the borrower to return the unauthorized ROI to the project.

    ◊ The Agency considers excess cash to be the portion of the ending cash balance on *Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance* that exceeds 20 percent of annual operating and maintenance expenses, the taxes and insurance escrow, and 2 percent money, if applicable.

    ◊ When determining positive net cash flow, the Agency will consider such items as accounts payable and reserve withdrawals to cover operating expenses. For example, the borrower may not circumvent the order for funding accounts by using reserve funds or creating an accounts payable for budgeted operating expenses to make it appear as though the budget has a positive cash flow at year-end.

- Since the Agency permits the current year's ROI to be taken from excess project funds at the end of the following fiscal year, the Agency will, in turn, permit the current year's ROI to be taken from excess project funds at the end of the current fiscal year. Under these conditions, the borrower must receive specific authorization from the Agency. Under all conditions, the borrower may not take an ROI from project funds until after the end of the project's current fiscal year.

- If the project's operations show a negative cash flow (see line 30 on *Form RD 3560-7*), the Agency may authorize the borrower to take the ROI only after the Agency has reviewed the project's annual financial report and determines:

- ◊ There is excess cash in either the general operating account or the reserve account; and
- ◊ The housing project has sufficient funds to address identified capital or operational needs.

- The borrower may take the ROI from the reserve account if the conditions set out in the loan agreement are met.

Example
Case One: Consider a project that has been operational for eight years, has a $1,000 ROI specified in the loan agreement, and needs $10,000 excess cash to cover 20 percent of annual operating and maintenance expenses and taxes and insurance escrow. If the project had a negative cash flow after payment of operating and maintenance expenses, reserves, and debt service expenses during the calendar year (CY) 2003 but had $20,000 available in the general operating account, the Agency would approve an ROI from funds available at the end of CY 2003. If the project had a negative cash flow during CY 2003 but had only $5,000 available in the general operating account, the Agency would not approve an ROI from funds available at the end of CY 2003 **Case Two:** Consider the same project as described in Case One. During CY 2003, the borrower believed that there would not be adequate cash to pay taxes at year end, so the borrower requested $2,000 from the reserve account for operating purposes; however, the project ended the year with $3,000. In this case, the borrower can take the $1,000 without Agency permission. However, if the net cash amount was less than $2,000, the borrower can only take ROI from excess cash.

SECTION 3: REPLACEMENT RESERVES *[7 CFR 3560.306]*

4.12 PURPOSE OF RESERVES

The Agency has a financial interest in a project over the life of its loan. During this period, which can be as long as 50 years, major replacements and capital expenditures will have to be made to the building, such as replacing the roof, rewiring, replacing windows, doing major exterior work, and adding new kitchen and bathroom fixtures. The reserve account is primarily used to meet the major capital expense needs of a project. If these expenditures are not made, the property loses value, becomes less attractive to tenants, and begins to deteriorate, and the Agency's financial interest is at risk.

In most cases, such expenditures cannot be met out of annual operating income. Therefore, the Agency requires that a certain amount of rental income each month be deposited in a special, interest-bearing savings account—a reserve account—with rates greater than or equal to passbook savings or checking accounts. The Agency's expectation is that over time, the accumulation of funds in this account will be sufficient to meet these major capital costs. Adequate replacement reserves are a critical component of a successful project.

4.13 RESERVE ACCOUNT REQUIREMENTS

The reserve account is a required account subject to the requirements set out in this paragraph. The borrower will initiate monthly deposits in this project account, starting the same month the first loan payment is due the Agency. As projects age, the required reserve account level may be adjusted to meet anticipated life-cycle needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

- All Rural Rental Housing, Rural Cooperative Housing, and Farm Labor Housing borrowers are required to establish and maintain a reserve account. This requirement excludes On-Farm Labor Housing borrowers with less than12 units.

- Effective July 26, 1994, reserve funds were required to be placed in a supervised account. The provisions of 7 CFR part 1902, subpart A, apply. Reserve funds on deposit prior to this date in instruments that are subject to monetary penalties for early withdrawal may be temporarily held for the time needed to avoid such penalties.

4.14 RESERVE INSTALLMENTS

Immediately after paying each installment for the orderly retirement of the Agency loan as provided in the borrower's *Form RD 3560-52*, *Promissory Note* required reserve installments will be transferred to the Reserve Account at least at the required rate stipulated by the borrower's loan agreement or resolution starting with the date the first payment is due to the Agency. Transfers will continue until the account reaches the total amount specified in the loan agreement or resolution. Transfers will be resumed the period following withdrawals that decrease the reserve account balance below its required level until it is restored to the specified total minimum sum.

As projects age, the required reserve account level may be adjusted to meet anticipated "life-cycle" needs, including equipment and facility replacement costs, by amending the loan agreement/resolution.

The Agency may approve a change in the reserve account funding level based on the findings of an approved capital needs assessment. The approval to increase reserve account funding levels will take into consideration the housing project's approved budget and the housing project's ability to support increased reserve account deposits without causing basic rents to exceed conventional rents for comparable units in the area.

The Agency may approve a borrower's request to increase the required level of the reserve account to ensure sufficient funds are available to address capital requirements of a transition plan. Loan funds may also be used for this purpose.

4.15 RESERVE ACCOUNT PRINCIPLES

Reserve account funds are governed by the following principles:

A. Investment Vehicles and Institutions

Reserve account funds not immediately needed to pay for expenses or authorized purposes may be held as set out in this paragraph. Reserve account funds may be held in the form of a checking, savings, negotiable order of withdrawal, or similar account at a federally insured domestic institution, such as a bank, savings and loan, or credit union.

- Reserve account funds may be held in the form of readily marketable obligations of the U.S. Treasury Department (e.g., U.S. Treasury bonds, U.S. Savings bonds, zero coupon bonds, etc.) at a federally insured domestic institution or at an insured domestic institution authorized to sell securities.

- Reserve account funds may also be held in the form of an account (the account may be a tax exempt account or a taxable account) established at an insured domestic institution authorized to sell securities (the institution may or may not charge brokerage fees), provided the accounts meet the remaining conditions set out in this paragraph and are not used in a speculative manner.

B. Limitations on Investments in Securities

Any securities must be backed by the U.S. Government or an Agency of the U.S. Government, or be triple A-rated Government National Mortgage Association collateralized tax-exempt bonds or be triple A-rated pre-refunded bonds. Pre-refunded bonds are bonds that originally may have been issued as general obligation or revenue bonds but are now secured, until the call date or maturity, by an escrow fund consisting entirely of direct Government obligations that are sufficient for paying the bondholders.

C. Reporting Actual Costs of Securities

To assure that required amounts have been paid into the reserve account, the actual costs of securities (which in many cases may not be the face value) must be shown on the project books. In addition, details of these transactions should be disclosed in footnotes to financial information provided to the Agency.

1. Security Sales

When the Agency approves withdrawals from the reserve account and the funds are invested in securities, borrowers must, to the extent that securities are available, assure that securities are sold in an amount that results in proceeds sufficient to cover the disbursement.

2. Forecasting Security Sales

Since the sale or redemption of any securities may result in cash proceeds of less than the amount invested, borrowers should take steps to minimize the risk of loss from converting securities to cash. Needed reserve account withdrawals should be forecasted well in advance to permit Agency approval of anticipated needs, such that security sales can be arranged to be sold in favorable market conditions. When sales of securities take place, the proceeds will normally be held in a reserve fund at a domestic bank, savings and loan, credit union, or similar institution insured by an Agency of the Federal Government until such time as withdrawals are actually needed for the purposes authorized. Should unusual circumstances require the sale of securities in unfavorable market conditions, the borrower will not be required to reimburse the project for any losses incurred.

3. Knowledge Required of Securities Investors

Those investing in securities must be knowledgeable of common industry practices prior to investing in securities. Knowledge of the various fees that may be associated with the purchase and sale of securities and the maintenance of security accounts must be considered when making security investments (e.g., front-end loads or fees, back-end loads or fees, maintenance fees, etc.). Such fees may be paid by the general operating account or by the reserve account. However, the Agency must give its prior consent before reserve account funds may be used.

4. Financial Advisor Limitations

Project proceeds may not be permitted to be used to pay for the services of a financial advisor to assist in the selecting of securities for investments, since the securities permitted are relatively limited and must meet the requirements set out herein. However, normal brokerage fees may be paid to secure and sell securities. It is recognized that financial advice may also be provided as part of the normal brokerage fee.

4.16 ELIGIBLE USES OF THE RESERVE ACCOUNT

A. Planned Use of Reserves

The borrower will request withdrawal from the reserve funds using *RD Form 3560-12, Request for Authorization to Withdraw Reserve Funds,* before they are needed. Annual budgets are to include realistic routine income and expense levels to avoid the need to use the reserve for routine expenses (operating shortfalls), not caused by emergencies or very unusual servicing situations. The Agency expects borrowers to anticipate and plan for major capital expenditures at least annually.

The borrower is required to submit an annual capital expenditure budget as part of the annual budget submission. The Loan Servicer reviews these documents, as well as the annual report of actual expenditures to ensure that the borrower includes expenditures adequate to maintain the property to Agency standards. This should include plans to catch up with any maintenance expenses deferred from previous years, or to correct any deficiencies identified during Agency site visits. Marshal and Swift "Residential Cost Handbook" provides data on projected useful life of materials with graphic representations of common replacement and repair schedules for reference.

The borrower must submit a written request to the Agency to use reserve funds, even if the Agency has reviewed and approved the capital expenditures in its review of the annual capital budget.

B. Unanticipated Uses of Reserves

The Agency recognizes that not all capital expenditures can be predicted a year in advance. Sometimes a major piece of equipment will break down unexpectedly or a severe storm will create damage. Borrowers must seek Agency approval for the unforeseen use of reserves. In emergency situations when the borrower can demonstrate an imminent and serious threat to the health, safety, or physical security of the project, the borrower may request the Agency to post-approve the use of reserves. The Agency will only approve emergency withdrawals if the reserves are used for eligible expenses.

C. Authorized Uses/Eligible Expenditures

The Loan Servicer will take prompt action on a request for reserve withdrawal (normally within 5 working days of the request) and provide written authorization to the borrower for any authorized withdrawal of funds by the use of *Form RD 3560-12* before the borrower actually withdraws any funds. Authorized purposes include:

- To make improvements to the housing project without creating new living units or to retrofit units to make them accessible to the physically handicapped.

- The use of reserve funds to address the capital requirements identified by the borrower's transition plan may be considered an authorized use of reserve account funds. Loan funds may also be used for this purpose.

- Make permanent improvements to the housing project, such as installing an energy-conserving heat pump or making a unit accessible to persons with disabilities.

- For other purposes desired by the borrower, which in the judgment of the Government will promote the loan purposes; strengthen the security; or facilitate, improve, or maintain the project and the orderly collection of the loan without jeopardizing the loan or impairing the adequacy of the security. Reserve funds may also be used to facilitate payment of fees associated with the buying or selling of securities or maintaining a securities account.

- To meet payments due on the loan obligations in the event the amount for debt service is not sufficient for that purpose.

- Meet an emergency shortfall in operating expenses when the emergency is beyond the control of the borrower and threatens life, safety, or the physical security of the project. Examples might include an extreme weather disaster or reductions in rental income caused by changes in the rental market that affect other housing projects as well. In cases of weather disasters, the project insurance coverage will be reviewed to determine if funding from insurance will be available for repairs.

- With Agency approval, borrowers operating on a for-profit or a limited profit basis may make an annual withdrawal from the reserve account, equal to no more than 25 percent of the interest earned on a reserve account during the prior year. The borrower uses *Form RD 3560-12*, requesting the withdrawal and must provide documentation of the prior year interest earned.

- To pay a ROI at the end of the borrower’s project operating year, provided that after these disbursements the amount in the reserve account will not be less than that required by the loan agreement or resolution to be accumulated by that time (taking into consideration the provisions of any approved servicing plan which may be authorizing a temporary adjustment to these provisions), minus any authorized withdrawals, and provided that the amount in the reserve account will likely not fall below that required to be accumulated during the next 12 months.

    ◊ In the case of borrowers’ operating on a limited-profit basis, paying a return on the borrower’s initial investment as identified in the loan agreement or resolution; and

    ◊ In the case of borrowers’ operating on a full-profit basis, paying an annual return as specified in the borrowers’ loan agreement or resolution.

4.17 THE WITHDRAWAL PROCESS

A. Common Procedure

The procedures that the borrower and the Agency use vary with the complexity and cost of the project for which reserve funds are sought. However, some steps are used in all cases:

- The borrower writes to the Field Office using *Form RD 3560-12* to request the use of reserve funds for a capital expenditure. The request will include:
  - ◊ A statement of the purpose and a description of the project for which reserves will be used;
  - ◊ The current balance in the account and other activity, such as deposits and withdrawals;
  - ◊ The estimated cost of the project;
  - ◊ Copies of bids, if appropriate;
  - ◊ A copy of the approved capital budget that included the project or an explanation of why the project was not included in the annual capital budget; and
  - ◊ A statement of the current balance in the reserve account.
- The Servicing Office reviews the request:
  - ◊ If the request is for a project that was included in the annual capital budget and approved during the Agency review of the engagement report, and is not a substantial construction activity, the Servicing Office must complete its review within <u>5 business days</u>.
  - ◊ If the request is for a capital expenditure that is not an emergency and was not part of the annual capital budget, the Servicing Office has <u>10 business days</u> to complete its review.
- The Servicing Office notifies the borrower in writing of the decision to:
  - ◊ Approve the request;
  - ◊ Approve the request with conditions; or
  - ◊ Reject the request (this must include the reasons for rejection and an explanation of the borrower's appeal rights).

- The borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

B. Bid Requirements

The expenditure of reserve funds for a project (all work included in one contract) estimated to cost more than $5,000 will require a minimum of two bids. Where there is an identity of interest (IOI) between the borrower or property manager and a bidder, the entity with the IOI must submit its bid directly to the Servicing Office, prior to requesting bids from other firms. The Agency requires at least two bids from other firms or an explanation of why the borrower was unable to obtain two bids.

C. Projects Involving Moderate Levels of Construction

These are projects that do not involve any substantial changes to the structure or replacement of major systems (electrical, plumbing, heating, or cooling) and cost less than $100,000. Examples could include exterior repainting, roof repair, parking lot repaving, and repairs to plumbing or electrical systems. When the borrower requests access to reserves for a moderate construction activity, the Agency first reviews the project documents and then reviews a payment request.

In addition to the items specified above, the borrower must provide:

- Project planning documents that describe the work to be performed;
- Copies of written bids; and
- A copy of the contract/proposal.

After the project has been completed, the borrower submits a request for payment, supported by an invoice and accompanied by a two-party check made out to the vendor or contractor.

D. Larger Construction Items

These activities involve substantial changes to the structure, replacement of major systems, or expenditures in excess of $100,000. Such activities are subject to the design requirements of RD Instruction 1924-A and RD Instruction 1924-C. In addition to the items specified above, the borrower must provide:

- Project planning documents, including specifications and drawings as necessary to fully describe the work;
- Copies of written bids;
- A rationale for awarding the contract; and
- A copy of the construction contract.

The required planning documents may be prepared by any individual or firm meeting the qualifications requirements of the local building jurisdiction. After the planning documents and construction contract have been accepted by the Agency, the borrower may request an initial draw to pay for materials or make a down payment to the contractor. The request for an initial draw should be accompanied by an invoice and a check made out to the contractor or vendor, to be cosigned by the Agency. The Agency may approve such a request provided the amount of the initial draw does not exceed a reasonable percentage of the value of the construction contract.

The Agency will inspect the project before approving the work and again at construction completion before approving the final payment. The purpose of the initial inspection is to establish that the proposed work is needed and an appropriate response to existing conditions. The purpose of the final inspection is to establish that the work was performed as described in the Agency-accepted documents. The Agency may conduct additional inspections as necessary. The borrower should be required to hire an independent third-party inspector to verify that the work complies with all applicable requirements.

4.18 EXCESS RESERVES

Any amount in the reserve account that exceeds the total sum specified in the loan agreement or resolution may be transferred to the general operating account for the authorized purposes only when it is agreed between the borrower and the Agency to be in excess of the requirement and there is a specific need for the excess funds. However, the Loan Servicer may direct the excess sum to be retained in the reserve account or applied as an extra payment on the loan.

SECTION 4: PROJECT BUDGETS

4.19 BUDGET REQUIREMENTS *[7 CFR 3560.303]*

Project budgets are planning documents that provide a picture of project financial operations. They reflect the project's expected revenues and expenses, including plans for maintenance, capital improvements, reserve account activity, and the owner's return for the coming year. Within twelve months of the date of publication of the interim final regulation, for projects with eight units or more, all borrowers will be required to submit project budgets through the Management Agent Interactive Network or MINC. The Agency may make an exception to this requirement if the borrower submits documentation that the costs associated with electronic submission of tenant certifications would pose a financial hardship to the project.

Borrowers must submit annual project budgets to the Agency for approval. Budgets must meet the following requirements:

- Budgets must be reasonable and realistic. Revenues and expenses must be consistent with past project budgets and comparable projects. Any differences must be due to legitimate operating needs of the project.

- Project expenses can include only expenses necessary to maintain successful projects. (An example of an unnecessary expense is owner or manager entertainment expenses.) Project expenses cannot be used for unearned personal benefit or gain, or for reimbursement of false or inaccurate expenses.

- The borrower must not include expenses for purposes unrelated to the housing project or for fines, penalties, and legal fees where the borrower has been found guilty of violating laws such as civil rights, evictions, and building codes.

- The borrower is responsible to submit project budgets that address the project's physical accessibility needs. The Loan Servicer may approve the cost of providing accessible rental housing as an authorized use of project funds.

- The borrower must not include organizational expenses among project expenses. These items are covered by the management fee. (For a list of items covered in the management fee, see **Chapter 3**.)

- With prior Agency approval, nonprofits and cooperatives may request a Nonprofit Asset Management Fee. This fee may reimburse the borrower for the cost of errors and omissions insurance and actual expenses prorated by the number Rural Development projects not to exceed $7500. The oversight functions include:

    ◊ Board of Director's review and approval of proposed budgets, including proposed repairs, outlays, and accruals;

    ◊ Review of capital expenditures over $500;

◊ Approval of annual financial reports and considerations of any management comments noted; and

◊ Long-term asset management reviews.

- The priority order of project expenditures must be:

◊ Prior lien holder, if any;

◊ Operating and maintenance expenses, including taxes and insurance;

◊ Debt service to the Agency;

◊ Reserve account deposits;

◊ Other authorized expenses; and

◊ Return on the owner's investment or Nonprofit Asset Management Fee.

4.20 ANNUAL CAPITAL EXPENDITURE BUDGET

A. The Role of the Borrower

The borrower identifies major maintenance and replacement needs during the annual budget cycle and develops a schedule for making withdrawals from the reserve account to pay for their cost. These plans are incorporated by the borrower into the annual capital expenditure budget, and may also be reflected in the operating budget if the work is to be paid for out of operating income.

B. Agency Review

The Loan Servicer uses the budget cycle to assess the borrower's annual capital expenditure budget compared with available information about the types of capital improvements needed to maintain the project's physical condition. Independent sources of information such as RS Means "Repair and Remodeling Cost Data" and Marshall and Swift "Residential Cost Handbook" should be consulted for common costs and repair/replacements schedules.

The Loan Servicer reviews the operating and annual capital budgets, and compares them with previous budgets, site visit reports, physical inspections, capital needs assessments, and audit reports. When doing so, the Loan Servicer should consider the following questions:

- Are expenditures sufficient to maintain the project according to the Agency's performance standards and the requirements of the project management plan?

- Were any essential items of maintenance deferred during the past year, which should be financed from the upcoming operating or capital budget?

- Are there any uncorrected defects noted in site visit reports that should be financed from the upcoming operating or capital budget?

- Has a capital needs assessment of the property been prepared?

- Is the amount budgeted for maintenance and replacement reserve expenditures sufficient to address immediate capital needs?

- If capital needs information is available, are replacement reserve contributions and funding levels sufficient to address anticipated capital needs over the next 5 years?

If the Loan Servicer finds the operating and capital budgets inadequate to keep the project in compliance with Agency standards for physical conditions *[7 CFR 3560.103]*, the Loan Servicer must request the borrower to modify the annual capital plan. The Loan Servicer may also request modifications if it is found that the borrower has proposed expenditures to be paid from reserves that should be charged to the operating account.

4.21 SCHEDULE FOR BUDGET REVIEW AND APPROVAL

The schedule for submitting budgets depends on whether the proposed budget includes a rent change. Budgets with rent increases require extra time for approval. Exhibit 4-1 outlines the schedule for budgets with and without rent increases.

A. Agency Review Time

The total Agency review time for a budget from submission to initial approval or rejection is:

- Thirty days for budgets without rent increases; and

- Sixty days for budgets with rent increases.

If the initial budget is rejected, this schedule allows for a second review of the budget and approval (if appropriate) before the start of the fiscal year. However, the Agency must take action on all budgets within 60 days of receipt of the borrower's budget.

B. Late Budget Submissions

The schedule provided for budget reviews relies on timely submission of budget documents by the borrower. If the borrower is tardy in submitting required documents, the Agency cannot ensure that all deadlines will be met. Therefore, if a borrower submits the budget late, Agency deadlines no longer apply, and the borrower is not eligible for "automatic approval" of the budget (as discussed in Paragraph 4.30 B.). If no budget is approved by the end of the project's fiscal year, the borrower must operate under the previously approved budget until the Agency reviews and approves the new budget.

Exhibit 4-1

Schedule for Budget Submission and Review

Budgets without Rent Increases	
60 calendar days prior to end of the project's fiscal year *November 1**	Borrower submits budget documents to Agency. Agency has 30 days total to review the complete budget
30 calendar days prior to end of fiscal year *December 1*	Agency approves or denies the budget.** • If the budget was denied, the borrower may submit additional information to address deficiencies within 10 days. • Agency makes final approval or rejection of budget within 20 days of receipt of this information.
End of fiscal year *December 31*	Final approval or rejection of the budget. If budget is rejected, the current year's budget remains in effect.
Budgets with Rent Increases	
90 calendar days prior to end of fiscal year *October 1**	Borrower submits budget documents to Agency and notifies tenants of requested rent increase. • Tenants have 20-day comment period to get back to the borrower. • Within 30 days of receipt, the Agency must reject the budget or contact the Borrower requesting additional information or clarification. • Agency has approximately 60 days total to review the budget.
60 calendar days prior to end of fiscal year *November 1*	Agency provides notice to the borrower of budget approval or denial.** • If the budget was denied, the borrower may submit additional information to address deficiencies within 10 days. • Agency has 20 days to review the additional information.
30 days prior to end of fiscal year *December 1*	Agency gives final approval or denial of the budget. • If the budget is approved, tenants must have at least 30 days' notice or notification required by local law before the rent increase takes effect. (If the notices given to tenants at the outset stated the amount of the effective increase, then notice has been given). • If the rent increase is denied, the borrower may submit a revised budget at previously approved rents with expenditures acceptable to the Agency. In the absence of such a revised budget, the current year's budget remains effect.
Beginning of project's fiscal year *January 1*	New budget and rent increase take effect.

* The dates provided are for a sample project with a fiscal year that begins January 1. For projects with different fiscal years, adjust accordingly.
** If the borrower submitted the budget on time, and has not been notified by the Agency of any deficiencies by this time, the budget is considered approved unless it is not eligible for automatic approval.

C. Steps in Budget Review and Approval Process

When reviewing and approving budgets, Loan Servicers must take the steps shown in Exhibit 4-2.

Exhibit 4-2

Steps in the Budget Review and Approval Process

- Follow procedure for receipt of budgets;
- Prioritize budgets for review;
- Review outstanding monitoring findings;
- Review the budget for reasonableness;
- Review the reserve account,
- Review the rent change, if requested; and
- Approve or deny the budget.

Budgets for projects that receive HUD Section 8 assistance need to be reviewed with the same rigor as other projects. However, there are certain procedures that differ. These procedures are discussed later in the chapter.

4.22 RECEIVING THE BUDGET

Standard procedures for budget receipt will help Loan Servicers to track the progress of budgets through the approval process and meet approval deadlines. Further, intake procedures should help prioritize the review of budgets so that those with the highest priority (e.g., those with rent changes) receive the attention they need in a timely manner. The borrower must submit a budget narrative, budget form (*Form RD 3560-7* or other form as approved by the Agency as part of the budget submission.

1. Budget Narrative

The budget narrative provides a description of the budget and highlights important elements to aid Loan Servicers in their review of the budget. Items to be covered in the budget narrative are listed in Exhibit 4-3.

Exhibit 4-3

Items to Be Covered in a Budget Narrative

- A brief description of the project and its status. The description should address key indicators of project status. For example, it should highlight any issues concerning vacancies, unexpected maintenance, or other items that affect the budget.
- A statement of project compliance. This statement should indicate any outstanding monitoring findings and the borrower's progress in addressing these compliance problems.
- A description of the project's financial status, highlighting the project's overall financial status, important changes during the last year, and factors contributing to financial difficulties.
- An explanation of any changes in project expenses or cash sources that exceed the tolerance threshold.
- An explanation of projected capital expenditures and reserve withdrawals for the upcoming year and capital needs for the next three years beyond the budget year.
- If applicable, a statement that the proposed budget includes a rent increase and reasons for the increase.
- Any additional documentation necessary for the Agency to establish that applicable Agency requirements have been met.

2. Form RD 3560-7, Multiple Family Housing Project Budget/Utility Allowance

This Agency form outlines the budget by line item and provides information on cash sources and uses, including rents and reserves.

3. Capital Budget

The capital budget form, Part V of *Form RD 3560-7* provides information on plans for capital improvements. It lists all the capital items in the project and provides space for the borrower to indicate their condition and any needed improvements.

Procedure for Receiving Budgets

The following steps are taken upon receipt of budget submissions:

- When hard copies of the budget are submitted, the Loan Servicer should date stamp them, enter them into MFIS, and forward them to the appropriate Servicing Official.
- When the borrower's notification of intention to request a rent increase is received, the Loan Servicer should establish a rent change folder for tenant comments.
- When tenant comments are received, the Loan Servicer should review, record, and file them.

4.23 BUDGET REVIEW

A. Procedure for the Budget Review

The following items must be checked in the review:

- Verify that all required items in the budget narrative have been addressed (see Exhibit 4-3 for a listing).

- Review *Form RD 3560-7* to verify that all appropriate line items are completed. Perform a quick assessment to ensure that they appear to be completed properly.

- Verify that the capital budget is complete. Capital improvements needed to implement a borrower's transition plan should be included as part of the capital budget portion of *Form RD 3560-7,* when applicable. Compliance-related costs include reasonable fees and costs for preparing self-evaluations and transition plans.

If the budget is complete, the budget review should continue as described in the following sections. If the budget is incomplete, the Loan Servicer must take the steps described below.

B. Incomplete Budgets

If any items are missing or are of such poor quality that there is insufficient information to begin an assessment of the budget, the budget is considered incomplete.

If the budget submission is incomplete, the Loan Servicer must contact the borrower, stating that the budget is incomplete, and discuss the deficiencies.

- If the borrower does not submit the requested information within a <u>10-day</u> time period from the Agency's contact, the Agency cannot guarantee approval of the budget before the beginning of the new fiscal year. In these cases, the borrower must continue operations under the previous year's budget until a budget is approved. The borrower is not eligible for automatic approval as described in Paragraph 4.28 B, and the budget will be returned unapproved.

- If the borrower does submit the information within <u>10 days</u>, the budget is considered to be on time, and the review can still be completed prior to the end of the fiscal year. The budget is eligible for automatic approval, as described later in this chapter.

4.24 PRIORITIZING BUDGETS FOR REVIEW

After budgets have been received and determined to be complete, the Loan Servicer should prioritize budgets for review. Prioritizing the budgets helps to ensure that the budgets that require the most thorough review receive the attention they need. Budgets with the highest priority for review include budgets for projects with:

- Requests for rent increases above $25;
- Vacancy rates above the allowable threshold; and
- Past monitoring findings.

While Loan Servicers should place the highest priority on reviewing these budgets, they should plan their time to allow for sufficient review of all budgets.

4.25 REVIEWING OUTSTANDING COMPLIANCE ISSUES

Having determined that the budget submission is complete, the Loan Servicer must check the project for outstanding compliance findings and assess whether the borrower's budget narrative reflects adequate efforts to address these findings.

Specifically, the budget narrative must discuss the following issues and explain how they are addressed in the proposed budget.

- Any outstanding findings from last year's annual financial report;
- Outstanding findings from recent physical inspections or supervisory visits (to be renamed occupancy and management/administration reviews); and
- Workout agreement (if applicable).

If the outstanding monitoring issues have been adequately addressed in the budget narrative, the Loan Servicer should proceed with the review for reasonableness. If project compliance issues have not been addressed, the budget documents should be returned to the borrower for revision.

4.26 REASONABLENESS REVIEW

If all outstanding compliance issues have been addressed, the Loan Servicer must review the budget for reasonableness. The Loan Servicer must use the steps outlined in Exhibit 4-4 to make a determination of reasonableness.

A. Tolerance Threshold

In reviewing the proposed budget, Loan Servicers must apply a tolerance threshold of 10 percent. This means that when Loan Servicers perform the reasonableness analysis, if specific budget items (as identified in Exhibit 4-4) differ from the appropriate benchmark by more than 10 percent, they are considered to exceed the tolerance threshold and require additional analysis, as described in subparagraph D below.

B. Reasonable Vacancy Allowance

A vacancy allowance is considered reasonable if it does not exceed the previous 3 years' historical vacancy and contingency allowance in the property. However, the vacancy rate is capped at the following levels:

- For projects with 15 or fewer units, the historical vacancy rate is capped at 15 percent.

- For projects with more than 15 units, the historical vacancy rate is capped at 10 percent.

- In unusual circumstances when vacancy rates exceed caps, a workout plan must be submitted prior to receiving budget approval.

C. Utility Allowance Analysis

Depending upon the rate of change in costs, the borrower must provide the following documentation describing the utility allowances:

- If utility costs have changed significantly (over 15 percent):

  ◊ Documentation of the extent of the utility rate changes. This may include billing information or documentation from utility companies; and

  ◊ A significant sampling of tenant utility usage from the utility company. If tenant utility information is unavailable from the utility company or only provided at cost, utility billings received by tenants are acceptable.

- If utility costs have changed moderately (15 percent or less):

  ◊ Information regarding rate changes; and

  ◊ A sampling of individual tenant utility usage.

- If there are no changes in utility rates:

  ◊ Documentation in the annual budget indicating that no change in rates has occurred during the period being reviewed; or

  ◊ A public release from the utility provider indicating no change in rates has occurred during the period reviewed.

- If there has been no documentation provided on utility usage during the most recent period:

  ◊ Documents as if utility costs have changed significantly; or

  ◊ Letter from utility company saying there has been no increases in rates.

D. Procedure for Reviewing Cost Increase Justifications

If the reasonableness analysis reveals that the subtotal for any operating expense category—maintenance and operating costs, utilities, administration, or taxes and insurance—exceeds the tolerance threshold, the Loan Servicer should review the budget narrative to determine whether the borrower provided adequate documentation that the expenses for this category are reasonable and necessary. For example, the borrower might provide documentation of the following:

- Costs are comparable to the costs for similar properties in the conventional market. For example, the borrower might show that insurance costs for the same coverage at a conventional project are comparable to the costs for the project shown in the budget.

- The factors contributing to the cost increases are beyond the borrower's control and the borrower is actively implementing cost-containment measures. For example, the project is subject to utility rate or tax increases.

- The cost increase is needed to cover actions to address identified physical deficiencies that are not due to negligence by the borrower or the management agent. Physical deficiencies that are due to negligence by the borrower or the management agent are not acceptable reasons for a rent increase.

If the explanation for the rent increase is not acceptable, the budget should be rejected.

Exhibit 4-4

Review for Reasonableness

The reasonableness review involves three steps as described below:

Step 1: Review the operating expenses, income sources, and vacancy allowance.

- **Operating expenses:** Check operating subtotals (O&M, Utilities, Administrative, Taxes and Insurance (T&I):
  - ◊ Are operating subtotals more than 10 percent different from last year?
  - ◊ Are operating subtotals more than 10 percent different from comparable properties?
- **Income sources:** Check income sources (rental and subsidy, nonrental)
  - ◊ Are income sources more than 10 percent different from last year?
  - ◊ Are income sources more than 10 percent different from comparable properties?
- **Vacancy allowance:** Is the vacancy allowance reasonable? 15 percent for projects with 15 or fewer units, 10 percent for projects with more than 15 units.)
- **Utility allowance:**
  - ◊ Has appropriate documentation been provided to justify the utility allowance?
  - ◊ Does the documentation provided demonstrate that the utility allowance is reasonable and comparable to other projects in this market area?

If the answer to any of these questions is no, determine whether the budget narrative provides an adequate explanation for the unusual item.

Step 2: Check cash uses. Does the budget reflect the:

- Correct debt payment?
- Reasonable non-operational cash use?
- Correct reserve payment?
- Owner's return on investment?

If the answer to any of these questions is no, the borrower must submit a corrected budget.

Step 3: Look at the cash flow and ending cash balance.

- **Cash flow:** Is cash flow positive? A negative cash flow is permissible as long as it does not appear to represent a trend that cannot be corrected.
- **Cash balance:**
  - ◊ If cash flow is negative, what is the ending cash? Does it cover the negative cash flow?
  - ◊ Does the ending cash balance exceed the permissible limit? If so, the excess must be contributed to reserves.

If the analysis of cash flow and cash balance reveals a problem, appropriate servicing actions should be considered prior to budget approval.

4.27 REVIEWING THE RESERVE ACCOUNT

The Loan Servicer must review the reserve account levels and contributions to ensure that they are consistent with the loan agreement. The Loan Servicer will review the borrower's project account bank statements to validate the actual reserve account balances during this analysis. This review focuses on four items:

- **Beginning balance.** The Loan Servicer should review the beginning balance of the reserve account and both the total and the per-unit amount to ensure accuracy.
- **Transfers to reserves.** The Loan Servicer should check the budget to ensure that the appropriate dollar amount, as specified in the loan agreement/loan resolution, is budgeted for deposit in the reserve account.
- **Transfers from reserves.** Any transfers from the reserve account that are included in the budget should be described in the budget narrative and justified by the capital plan.
- **Ending balance.** The ending reserve account balance is calculated by taking the beginning balance, adding the transfers to the reserve account, and subtracting the transfers from the reserve account.

If the Loan Servicer finds that the reserve account level is not where it is supposed to be, that the budget does not show correct contributions to reserves, or that transfers from reserves are not adequately documented, the borrower must submit corrected budget documents.

4.28 REVIEWING THE RENT INCREASE (IF REQUESTED)

Even if the Loan Servicer has determined that the budget is reasonable based on the tests outlined in Exhibit 4-4, the rent increase must still be reviewed to confirm that the rent/utility allowance change will not adversely affect the marketability of the units and create a vacancy problem.

A. Reviewing the Rent Increase

If a review of the rent increase shows that the rent increase will adversely affect the marketability of units, the full rent increase cannot be approved. The borrower should seek a reduced rent increase and, if appropriate, request a servicing action that will enable the project to achieve a positive cash flow at lower rents. The Agency will not consider rent increases based solely on guaranteeing that the borrower will receive an ROI at the end of the project's fiscal year.

B. Standard for Allowable Rents for New Projects and Allowable Rent Increases for Special Servicing Actions

In establishing rents for new projects and for special loan servicing actions such as transfers, reamortizations, and prepayment, the Agency has introduced a market-based measure that serves as a standard for evaluating proposed rent increases. This measure, Conventional Rents for Comparable Units (CRCU), is an objective measure, specific to the quality of the unit that reflects the local market and serves as an indicator of the project's long-term feasibility.

The CRCU standard is a benchmark meant to maintain the affordability of program units and avoid a situation where basic rents are increased above local conventional rents, leading to noncompetitive rents, excessive need for rental assistance, and/or vacancy problems. Sources for determining CRCU include recent appraisals; current rental data from the Census Bureau, HUD, State housing agencies, or other reliable sources; market data provided in applications for new projects in the market area; and the Agency's review of the market. If it appears that an exception under the CRCU standard may be needed, Loan Origination or Loan Servicing staff should contact the National Office for further guidance about making such determinations.

The existence of the CRCU standard does not change the method for increasing rents. Rents remain cost based, which means that they are determined based on the project budget and must be justified by actual operating costs. The CRCU standard does <u>not</u> apply to annual budget submissions that request rent increases.

C. Exceptions to the CRCU Standard for New Construction and Special Loan Servicing Actions

As discussed in HB-1-3560, the Agency can make an exception to the CRCU standard when approving new projects or special servicing actions, and approve basic rents for a property that are higher than the CRCUs for the market area where the property is located, in limited circumstances when it is in the best interest of the Government and the program. The Agency may approve an exception to this standard when it is necessary to allow for decent, safe, and sanitary housing to be provided in market areas where conventional rents are not sufficient to cover necessary operating, maintenance, and reserve costs.

However, in no case may basic rents exceed CRCUs for a market area by more than 50 percent *[7 CFR 3560.60(c)(2)]*. This upper limit means that basic rents may never be more than 150 percent of the CRCU for the market area where the property is located. For example, if the CRCU for the market area was determined to be $300 per month, the Agency could approve an exception to allow basic rents for this unit size up to $450 per month, if there was adequate evidence that a month rent of $300 was insufficient to cover necessary operating, maintenance, and reserve costs for the proposed property in this area. In no case, however, could the Agency approve rents greater than $450 per month for a two-bedroom unit.

4.29 RENT CHANGES FOR UNITS RECEIVING HUD SECTION 8 ASSISTANCE *[7 CFR 3560.207]*

The Agency has the responsibility to review and approve project budgets annually based on need to meet cash flow and expense requirements. Therefore, the Loan Servicer cannot take into account HUD's adjustment for HUD Section 8 contract rents. The Loan Servicer must approve only the rents needed to provide sufficient income to meet approved project expenses.

A. Reviewing Budgets with HUD Subsidies

Since HUD- and Agency-approved rental rates frequently differ, it may be necessary to have additional information for properties with HUD Section 8 contracts. Exhibit 4-5 lists the additional information needed in the budget, depending upon the project type.

Exhibit 4-5
Reviewing Budgets with HUD Subsidies

Project Type	Needed In Budget
• **100 percent Section 8/515 without interest credit:** HUD contract rent rate is equal to basic rent.	• HUD contract rent.
• **100 percent Section 8/515 with interest credit:** HUD contract rent is greater than basic rent and less than note rate rent.	• Basic rent, HUD contract rent, and Agency note rate rent.
• **Less than 100 percent Section 8/515 without interest credit:** HUD contract rent is greater than note rate rent.	• HUD contract rent and note rate rent; difference is excess funds and deposited into reserves.
• **Less than 100 percent Section 8/515 with interest credit:** HUD contract rent is greater than basic and less than or greater than note rate rent.	• Basic rent, HUD contract rent, and Agency note rate rent.

B. Excess Rents

When reviewing the budget, if the Loan Servicer concludes that the HUD-authorized rent is more than what is needed to meet project expenses, a lesser amount than the HUD rent must be approved. When this occurs, in accordance with Exhibit 4-5 the borrower may be told to deposit the difference between the Agency-approved note rate rent and the higher HUD-authorized rate into the general operating account. At the end of the year, this excess rent must be deposited into the reserve account. The manager or borrower must use *Form RD 3560-29, Notice of Payment Due Report*, to document the required deposit in the reserve account.

4.30 APPROVAL OR REJECTION OF BUDGETS

Once the budget analysis is complete, Loan Servicers must notify the borrower if the budget has been approved or rejected.

A. Budget Approval

If the Loan Servicer has determined that the budget represents reasonable costs and adequately addresses all outstanding compliance issues in the budget narrative, the reserve account is current, and the rent change (if requested) is acceptable, the budget may be approved. To approve the budget, Loan Servicers must sign the budget (*Form RD 3560-7*) and send a copy to the borrower. The Loan Servicer must also enter the approval date in MFIS.

B. Automatic Budget Approval

Budgets that are not reviewed within the 60-day period are automatically approved unless:

- The budget proposes a monthly rent increase above $25 per unit; or
- Budgets are submitted late or miss other deadlines set by the Agency.

Addressing Rent Increases

Loan Servicers must make every effort to review budgets with significant rent increases within the time limits. Postponing approval is not an acceptable way to address rent increases.

If a budget is not eligible for automatic approval and no decision is made prior to the beginning of the project's new fiscal year, the borrower must continue operations under the previous year's budget. In these cases, the Agency must continue to work with the borrower to address the requested increase. When agreement is reached, a new budget may take effect.

- **Timeframe for automatic approval.** Automatic approval occurs within the following timeframes:
  - ◊ Budgets with no rent increase for automatic approval may be considered approved 30 days after the receipt of a complete budget. Borrowers who submit budgets (with no rent increases) on time and respond to all requests for additional information within the specified time periods can consider their budgets approved 30 days after submission, if they have not received notification from the Agency.
  - ◊ Budgets with rent increases eligible for automatic approval may be considered approved 60 days after the receipt of the original budget. Borrowers who submit budgets (with rent increases) on time and respond to all requests for additional information within the specified time periods can consider their budget approved 45 days after submission, if they have not received notification from the Agency.

- **Procedure for automatic approval.** In the case of automatic approval, the Loan Servicer must still sign *Form RD 3560-7* and return a copy to the borrower no later than the end of the first month of the project's fiscal year.

C. Budget Rejection

If the Loan Servicer rejects the proposed budget because it is found to be unacceptable (for reasons related to outstanding monitoring findings, cost reasonableness, reserves, or the rent increase), the borrower has an opportunity to address the deficiencies.

- The Loan Servicer must return the proposed budget to the borrower with a letter listing deficiencies.

- The Loan Servicer must enter the appropriate tracking steps in MFIS

- The borrower has 10 days to submit new information to the Agency. The borrower may adjust the size of the rent increase requested or provide new documentation to justify budget items.

- The Loan Servicer must review the new submissions within 20 days of receipt and either approve or reject the budget.

- If the budget is approved based on the new submissions, the Loan Servicer must sign the budget and send a copy to the borrower.

- If the budget is rejected, the Loan Servicer must send the borrower a letter stating the deficiencies and informing the borrower that the previous year's budget remains in effect. The borrower must be given the option to submit a new budget using the previous year's rent levels but adjusted for projected capital expenditures and other known changes for the coming year. The borrower may appeal the budget rejection in accordance with Agency appeal procedures.

SECTION 5: REPORTING AND FINANCIAL EXAMINATIONS

4.31 MONTHLY AND QUARTERLY REPORTS *[7 CFR 3560.307]*

A. Overview of Reports

Financial reporting provides the Agency and the borrower a means to monitor the project's financial progress.

- **Quarterly reports.** Quarterly reports, based on Borrower's Fiscal Year are required in the following situations:
  - ◊ At completion of new construction or substantial rehabilitation;
  - ◊ When the project is subject to a workout agreement; and
  - ◊ In the case of reamortization and transfer of an existing project loan.
- **Monthly reports.** Loan Servicers may require borrowers to prepare and submit these reports on a monthly basis when additional tracking and supervision are needed. (For example, when a project is subject to a workout agreement, when there has been a violation of program rules or reporting requirements, or when the project shows signs of financial distress.)

Loan Servicers may discontinue the reporting requirement for projects that have demonstrated consistent compliance with program requirements over a sufficient time period. Generally 12 months of consistent compliance is considered sufficient to discontinue the reporting requirements.

B. Review of Monthly and Quarterly Reports

The borrower must submit the required reports following the close of the reporting period (quarter or month, as appropriate), and submit them to the Agency by the 20th of the month following the reporting period. Upon receipt, the Loan Servicer must review these reports for the following:

- Look for red flags such as dramatic changes in income, expenses, the general operating account, or the reserve account.
- Check balances on accounts as discussed in Paragraph 4.3, to make sure that they are consistent with the management plan, loan agreement/resolution, and the budget.
- Check project expenditures against the budget. Make sure that the project is being operated in accordance with the approved budget.
- Check progress against workout agreements. Make sure that the borrower is taking any actions indicated in a workout agreement and is abiding by the established schedule for these actions.

4.32 ENGAGEMENTS AND PREPARATION OF ANNUAL FINANCIAL REPORTS [7 CFR 3560.308 and 7 CFR 3560.578]

A. General Requirements for All Borrowers: Annual Financial Reports

The requirements for fiscal years ending 12-31-07 and thereafter are to follow the reporting requirements outlined here in Section 4.32. Attachment 4-B, Audit Program has been modified by the financial reporting requirements below.

All borrowers who have a Section 515 Rural Rental Housing loan or a Section 514 Off-Farm Labor Housing loan must comply with the financial reporting requirements of this section.

To ensure that the project is in sound financial condition and is complying with the program financial management requirements, the Agency requires annual financial reports to be submitted by each borrower.

Exhibit 4-6 outlines the financial reporting requirements for the specific types of properties.

Exhibit 4-6
Year End Financial; Reporting Requirements

Type of Property	Forms RD 3560-7 and 3560-10?	Borrower Certification Of Performance Standards?	Agreed-Upon Procedures and Determinations *	Audited Financial Statements? (In accordance with Yellow Book Standards)
Rural Development project (1-15 units)	Yes	Yes	No	No
Rural Development project (16-23 units)	Yes	Yes	Yes	No
Rural Development project (24 + units)	Yes	Yes	Yes	Yes*
State and local governments, Indian tribes and Nonprofit Organizations (subject to OMB Circular A-133)	Yes	Yes	No	No**

*Must be completed by a CPA

**This Audit is in accordance with OMB Circular A-133 and submitted to the Agency as part of the Financial Reporting Requirements.

For projects with eight units or more, borrowers will be required to submit Forms RD 3560-7 and 3560-10 electronically through MINC. The Agency may make an exception to these requirements if the borrower submits documentation that the costs associated with electronic submission would pose a financial hardship to the project. Borrowers with less than eight units may submit hard copies to the Agency within 90 days of the project's fiscal year end.

B. Budget Actuals (Form RD 3560-7) and Balance Sheet (Form RD 3560-10)

Form RD 3560-7, will be used for end of year reporting using actual income and expenses. Form RD 3560-10, is a summary of the balances of the accounts, a listing of the liabilities, and long term debts and an indicator of the net worth of the project. Ending balances of the accounts listed on the Form RD 3560-7, in Part III should match the balances listed on the balance sheet, lines 1-4. The ending cash balance on Form RD 3560-7, line 33, should also match the balances listed on Form RD 3560-10, lines 1, 2, 5, and 6. These checks are a part of the analysis run in MFIS as well. Signatures are required on these forms, however if submitted electronically through MINC, signed copies will not need to be sent to the Rural Development Servicing Official.

C. Borrower Certification of Performance Standards

All financial reports must include a Borrower Certification of Performance Standards. Attachment 4-C shall be used by the owner to certify to these standards.

The Borrower must self-certify that:
- Required accounts are properly maintained and tracked separately;
- Payments from operating accounts are disclosed and accurately represented;
- Reserve amount is current (i.e., contributions are on schedule and the balance accounts for contributions less authorized withdrawals), and there are no encumbrances;
- Tenant security deposit accounts are fully funded and are maintained in separate accounts;
- Payment of owner return was consistent with the terms of the applicable loan agreement or loan resolution;
- Borrower/grantee has maintained proper insurance in accordance with the requirements of 7 CFR 3560.105; and
- All financial records are adequate and suitable for examination.

As a part of the Financial Reporting Requirements of the Agency, the following two Performance Standards are being added:
- There have been no changes in project ownership other than those approved by the Agency and identified in this certification. Non-Profit organizations certify that the board is active and maintains oversight of the property.
- The real estate taxes are paid in accordance with state and/or local requirements and that there are currently no delinquent taxes.

D. Agreed-Upon Procedures and Determinations

Borrowers with 16 or more units in their housing project must submit an agreed upon procedures report completed by a CPA according to the agreed-upon procedures and determinations established by the Agency in Attachment 4-D. The Agency's financial reporting requirements as set forth in 7 CFR Part 3560.308 require that CPAs conduct certain tests in connection with preparing the agreed-upon procedures report. The purpose of these tests is to determine whether the borrower/management agent is in compliance with applicable Agency requirements in the management and operation of the project. Attachment 4-E is an example Engagement Letter which will be used by a CPA. This Engagement Letter should include the agreed-upon procedure to be performed and the fees associated with the service. There may be circumstances where the auditor may ask for information from Rural Development due to third party verification requirements. The Servicing Official shall receive a complete copy of this signed Engagement Letter prior to releasing information to the CPA. Attachment 4-F is an example Report of this Agreed-Upon Procedures Report to be used by all CPAs performing these engagements.

D. Project Financial Audit

Borrowers with 24 or more units in their housing project must base their annual financial reports on a financial audit in accordance with generally accepted government auditing standards or GAGAS, as set forth in "Government Auditing Standards" (July 2007 Revision), established by the Comptroller General of the United States, and any subsequent revisions (this publication is commonly referred to as the "Yellow Book" or "Government Accounting Office Standards"). Attachment 4-G is an example of the Combined Financial Audit and Agreed-Upon Procedures Engagement Letter. This Engagement Letter should include the agreed-upon procedure to be performed and the fees associated with the service and shall be signed by the CPA and owner and submitted to the Agency Servicing Official prior to completing the Combined Report. Attachment 4-H is an example of a Combined Audit & Agreed-Upon Procedures Report to be used by all CPAs performing these engagements.

An audit should consist of the following items at a minimum:

- Independent Auditor's Report
- Financial Statements
  - Balance Sheets
  - Statements of Operations
  - Statements of Changes in Partner's Equity (Deficit)
  - Statements of Cash Flows
- Notes to the Financial Statements
- Supplemental Information
- Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards
- Audit Findings on Compliance

- Independent Accountants' Report on Applying Agreed-Upon Procedures
- Multiple Family Housing Borrower Balance Sheet – Form RD 3560-10
- Multiple Family Housing Project Budget – Form RD 3560-7

E. Other Financial Reports

Listed below are additions to the requirements outlined above:

Standards for State and local governments, Indian tribes and Nonprofit Organizations. These organizations must submit audits in accordance with 7 CFR part 3052 (OMB Circular A-133 requirement), with copies of the audit being forwarded by the borrower to the Servicing Official and the appropriate Federal cognizant agency for audit. Within USDA, the USDA, OIG shall fulfill "cognizant agency" for audit responsibilities, (see "cognizant agency" defined 7 CFR 3052.105.

The auditor may refer to the American Institute of Certified Public Accountants (AICPA) for additional guidance meeting these requirements. The term "Federal financial assistance" is defined in 7 CFR 3052.105, but, such federal assistance does not include rental subsidies (i.e., Rental Assistance). Circular A-133 requires reporting by non-Federal entities with loan balances in excess of $500,000 where the Federal Government imposes continuing compliance requirements (7 CFR 3052.205(b)(2)). RRH and Farm Labor Housing (Off-Farm) loan programs have continuing compliance requirements.

Organizations subject to A-133 must submit the A-133 single audit and the borrower's certified performance standards, Forms RD 3560-7 and 3560-10.

Additional opinions. The Agency may require additional opinions of financial condition and compliance, such as audits, to assure the security of the asset; to determine whether the project is being operated at a reasonable cost; or to detect fraud, waste, or abuse.

Annual financial statements. Any project audits independently obtained by the borrower must be submitted to the Agency.

F. Annual Financial Reporting Due Dates and Agency Review of Annual Financial Reports

1. Annual Financial Reporting Due Date

Annual financial reports including Form RD 3560-7 with 12 months of actual income and expenses, Form RD 3560-10, engagement reports, certification of performance standards and audits, as appropriate, are due in the Servicing Office no later than 90 days following the close of the project fiscal year.

If the annual financial reports cannot be submitted by the due date, the Borrower must present a request for extension supported by evidence that delay is at the request of the auditor, and the request has a reasonable explanation of why an extension of the due date is needed. The Servicing Official may authorize up to a 30-day extension of the due date.

If an explanation is not forthcoming from the Borrower, or the explanation received is without good reason, or the Servicing Official otherwise suspects fiscal difficulty. The Servicing Official may request the borrower to submit to the Servicing Office for review, the project bank statements for the general operating, reserve, and investment accounts covering the most recent 60 day period.

If the borrower fails to submit the requested bank statements by the date stipulated by the Servicing Official, the Servicing Official will immediately refer the matter to the OIG.

The Servicing Official may authorize the initial verification of review to cover a period up to 18 months for a new project whose first operating year was less than 6 months or when an existing owner changes their fiscal year.

2. Agency Review of Annual Financial Reports

Loan Servicers must review financial reports in accordance with guidelines provided in Exhibit 4-7 to ensure that they meet Agency requirements. In particular, Loan Servicers must:

- Confirm that the engagement (agreed upon procedures report or combined agreed upon procedures and audit report) was conducted as described in the requirements above;
- Confirm that the performance standards were certified as described above;
- Confirm that nonprofit and public bodies have submitted any OMB required annual financial statements;
- Note any findings identified in the engagement and determine corrective actions. These would be located in the findings of the AUP and the audit findings page;
- Utilize the MFIS analysis tool to perform the preliminary assessment of the financial statements; and
- Confirm the information submitted to the Agency electronically through MINC on Forms RD 3560-7 and 3560-10 is the same as the forms submitted with the financial reports from the auditor.

Exhibit 4-7

Agency Review of Annual Financial Reports

A. **Analysis of actual income and expenses.** Using the actual budget submitted, record the actual income and expenses in MFIS and note any unexpected variance. In doing so, address the following questions:

- Did the expenses in any of the main categories—maintenance and operating costs, utilities, administration, and taxes and insurance—differ by more than 10 percent from their proposed levels?
- Did the actual sources of income (rental, subsidy, and non-rental) differ by more than 10 percent from their proposed levels?
- Was the vacancy allowance in the permissible range?
- Were debt payments and reserve payments correct?
- Was non-operational cash use reasonable (as compared to last year)?

B. **Account maintenance, tracking, and disclosure.** Record in MFIS the account balances from the report and confirm that the financial report states that:

- Required accounts are maintained and tracked separately; and
- Payments from operating accounts are disclosed and accurately represented.

C. **Reserve account status.** From the financial report, record the amounts listed for the reserve balance, deposits, and withdrawals, and confirm that the financial report states that the reserve account is current and that there are no encumbrances on the reserve account funds.

D. **Tenant security deposit account status.** Record in MFIS the tenant security account balance from the financial report and confirm that the report shows that the tenant security deposit balance meets liabilities and that the funds are maintained in a separate account and in accordance with state law.

E. **Payment of return to owner.** Confirm that the financial report states that the payment of the owner's return was consistent with the terms of the loan agreement or resolution. Record in MFIS the actual return paid and its effect on cash flow, using the actual project budget.

F. **Insurance status.** Confirm that the financial report states that all relevant insurance requirements were met.

G. **Taxes and other assessments.** Confirm that the financial report states that taxes and other assessments are current. List any taxes or assessments that are not current.

H. **Issues of financial compliance and conditions.** Confirm in the financial report that any funds used for unauthorized purposes have been repaid.

I. **Payment of management fees.** Using the actuals in the financial report, confirm that the management fee was paid in accordance with the management certification and that the management agent is not charging the project for agent expenses.

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ATTACHMENT 4-A
ELIGIBLE PROJECT EXPENSES

There are generally accepted project expenses that should be charged to the operating account. Some of these expenses are listed below:

1. Actual direct personnel costs of permanent and part-time staff assigned solely to the project site. This includes managers, maintenance staff, and temporary help for both types of positions and can cover the following specific items:

   a. Gross salary;
   b. Employer FICA contribution;
   c. Federal unemployment tax;
   d. State unemployment tax;
   e. Workers compensation insurance;
   f. Health insurance premiums;
   g. Cost of fidelity or comparable insurance;
   h. Leasing, performance incentive, or annual bonuses;
   i. Direct costs of travel to off-site locations by onsite staff for property business or training; and
   j. Retirement benefits.

2. Legal fees directly related to the operation and management of the property, including tenant lease enforcement actions, property tax appeals and suits that result in a savings to the project and have prior Agency approval, and all legal and other project-relevant matters.

3. All outside accounting fees, if required by RHS, directly related to the preparation of the annual financial report, partnership tax returns, and K-1s, as well as other outside reports and year-end reports to RHS, HUD, HFA, or other governmental agency. (Preparation of income tax returns for project owners is not an acceptable expense.)

4. Repair and maintenance costs for the project may include:

   a. Maintenance staffing costs and related expenses;

   b. Maintenance supplies;

   c. Contract repairs to the projects (heating and air conditioning, painting, roofing, etc.);

   d. Make-ready expenses including painting and repairs, flooring replacement, and appliance replacement, as well as drapery/mini-blind replacement (turnover maintenance);

   e. Preventive maintenance expenses including repairs and maintenance of occupied units, as well as repairs and maintenance of common area systems;

   f. Costs of snow removal;

   g. Costs of elevator repairs and maintenance contracts;

   h. Costs of Section 504 compliance;

   i. Costs of landscaping maintenance, replacements, and seasonal plantings;

   j. Costs of pest control services; and

   k. Other related maintenance expenses.

5. Specific costs that may be charged to the Property are as follows:

   a. The costs of credit reports, police reports, and other checks related to tenant selection criteria for prospective residents.

   b. The costs of duplicating forms for those properties not owning a copier. This will include the costs of producing or purchasing forms and mailing or delivering those forms to the project site.

   c. All bank charges related to the Property, including purchases of supplies (stamps, checks, deposit slips, service fees, etc.).

   d. Costs of site-based telephone, including initial installation, basic services, directory listings, and long distances charges.

   e. All advertising costs related specifically to the operations of that project. This can include advertising for applicants or employees in newspapers, newsletters, radio, cable TV, and telephone books.

   f. Postage and delivery costs from the site, including expenses in mailing the material to RHS, HUD or other governmental agencies; tenants; verifying third parties; central management offices, etc.

   g. Partnership filing expenses including state taxes and other mandated state or local fees as well as other relevant expenses, costs of continuation financing statements, and site license and permit costs.

   h. Expenses related to site utilities, including actual costs and surcharges, as well as deposits and expense of utility bonds in lieu of bonds.

   i. Expenses related to industry interface and communications with main office. Site office furniture and equipment, including site-based computer and copiers, are included. Service agreements and warranties for copiers, telephone systems, and computers are also included

   j. Real estate taxes (personal/tangible property and real property taxes).

   k. All costs of insurance, including property liability and casualty, as well as fidelity or crime and dishonesty coverage for onsite employees.

   l. Costs of collecting rents onsite including bookkeeping supplies and record keeping items.

   m. Costs of preparing and maintaining tenant files and processing tenant certifications including all office supplies, copies, and other associated expenses—total expenses will not exceed $20 per unit per year.

   n. Public relations expenses relative to maintaining positive relationships between the local community and the tenants, and the management staff and the owners. Chamber of Commerce duties, contributions to local charity events, sponsorship of tenant activities, etc., are examples of such expenses. Total expenses will not exceed $20 per unit, per year.

   o. Tax credit compliance monitoring fees imposed by HFAs.

   p. All insurance deductibles as well as adjuster expenses.

   q. Professional service contracts (engagements, tax returns, utility allowances, architectural, construction, rehabilitation and inspection contracts, etc.).

   r. Training of site staff.

   s. Site manager salary for additional hours.

   t. Offset taxes on reserve income (phantom income).

ATTACHMENT 4-B
AUDIT PROGRAM

USDA

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250

AUDIT PROGRAM	Rural Development Rural Housing Service Multi-Family Housing Division Rural Rental Housing Program

This audit program provides instruction and guidance for independent public accountants in conducting agreed-upon procedures engagements of recipients of Rural Development loans, except for those audits required to be performed in accordance with Office of Management and Budget Circular A-133. The audit program is effective for the period ending December 31, 2005, and thereafter.

This audit program may not be changed, altered, revised, or modified without the concurrence of the Office of Inspector General.

APPROVED BY: Robert W. Young
ROBERT W. YOUNG
Assistant Inspector General
for Audit

9/29/04
Date

TABLE OF CONTENTS

I. GENERAL

A. PURPOSE

This guide is designed to assist independent public accountants ("practitioners") in conducting agreed-upon procedures engagements of Rural Rental Housing (RRH) properties financed by Rural Development. The RRH Program has a history of abuse involving the construction and ongoing operation of properties. This guide includes procedures to assist the practitioner in determining borrower and management company compliance with certain statutory, regulatory, and contractual requirements of the RRH Program. Thus, practitioners need to be familiar with laws, regulations, and procedures related to the RRH Program.

B. BACKGROUND

Rural Development uses cost certifications to verify that borrowers spent loan funds for eligible and actual costs when constructing apartment complexes as part of the RRH Program. Rural Development requires borrowers to annually report the financial operations of RRH properties on *Form RD 3560-7, Multiple Family Housing Project Budget*.

RRH borrowers typically use identity-of-interest companies in both the construction of apartment complexes and in managing the day-to-day operations of RRH properties. RRH borrowers that have an identity-of-interest with the borrower (general contractor) are required by Rural Development to report the actual costs of construction on *Form RD 1924-13, Estimate and Certificate of Actual Cost.* In addition, *Form RD 1924-13* must be submitted whenever there is an identity-of-interest relationship between a borrower and a subcontractor, material supplier, or equipment lessor.

The USDA Office of Inspector General has performed audits and investigations that identified significant fraud and abuse in the RRH Program. Some of the fraud and abuse related to construction includes: Ineligible, unsupported, and duplicate costs; misrepresentation by borrowers of their roles as general contractors; shifting costs (e.g., overhead expenses) that exceeded budgeted amounts to different cost categories on *Form RD 1924-13*; and using identity-of-interest companies which are merely "shell" companies to either inflate legitimate charges or bill properties for costs that were never incurred.

Similar abuse using identity-of-interest companies has been identified in the ongoing management of RRH properties. Borrowers and management companies also charge ineligible, unsupported, and duplicate expenses (generally for management related costs) to properties. Also, management companies frequently do not maintain suitable records when of properties, and overcharge for these services. Rural Development regulations refer to any scheme that improperly withdraws funds from RRH project accounts as "equity skimming."

USDA Office of Inspector General audits have also identified instances of conflicts of interest and a lack of independence on the part of certified and licensed public accountants when performing audits of RRH properties. Thus, practitioners should strictly adhere to the standards and principles of the American Institute of Certified Public Accountants' Code of Conduct and Bylaws and applicable State Boards of Accountancy.

C. PERTINENT REGULATIONS AND INSTRUCTIONS

Construction Cost:

The instructions for *Form RD 1924-13* provide guidance on eligible construction costs, as well as the required format for the presentation of costs. Rural Development has also established regulations that restrict the amount of builder's profit for each project, the use of identity-of-interest companies, and the business relationships of practitioners performing engagements of RRH construction costs. The following regulations and Rural Development instructions should be used as guidance:

- Rural Development Instruction 1924-A, and
- Rural Development Instruction 1944-E.

Management of Ongoing Operations:

Rural Development regulation RD 3560 provides details on allowable and unallowable operating costs, and places restrictions on the use of identity-of-interest companies and other activities related to managing RRH properties. The instructions for *Form RD 3560-7* also provides direction on eligible costs.

D. STANDARDS FOR CONDUCTING THE AGREED-UPON PROCEDURES ENGAGEMENTS

Practitioners are to perform attestation engagements using agreed-upon procedures of construction costs and ongoing operations in accordance with attestation standards established by the American Institute of Certified Public Accountant's (AICPA) and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States." The practitioner's report on agreed-upon procedures should be in the form of procedures and findings. (See exhibit A for an illustrative example.)

If practitioners become suspicious of fraud or illegal acts during the course of performing the agreed-upon procedures engagement, they are to promptly report these matters (regardless of materiality) to:

U.S. Department of Agriculture
Rural Development
Rural Housing Service
Director, Multi-Family Housing Processing Division
14th and Independence Avenue SW
Washington, D.C. 20250
(202) 720-3773

The report and workpapers prepared in the course of these engagements are subject to a quality control review by the USDA Office of Inspector General.

E. OBJECTIVES

The objective of the construction cost engagement is to verify the propriety of costs reported on *Form RD 1924-13*. The practitioner should be alert for kickbacks on the purchase of services and materials, billings in excess of agreed-upon prices, billings for nonexistent materials or services, “sweetheart contracts,” and the diversion of materials to other construction sites.

The objective of the ongoing operations engagement is to verify the propriety of operating and maintenance expenses reported to Rural Development on *Form RD 3560-7*, Part II, and reserve account activity reported on *Form RD 3560-7*, Part III. The practitioner should be especially alert for equity skimming schemes involving maintenance costs, and unauthorized withdrawals from reserve and tenant security deposit accounts.

Of primary concern is compliance with general contractor and management company requirements and the role of identity-of-interest companies in the construction and management of RRH properties.

II. CONSTRUCTION COST ENGAGEMENTS

A. AGREED-UPON PROCEDURES FOR THE CONSTRUCTION COST ATTESTATION ENGAGEMENT

The procedures in this section are designed to identify ineligible expenses and fictitious charges to Form RD 1924-13. RD Regulations 1924-A and the instructions for preparing *Form RD 1924-13* provide guidance on eligible construction costs.

Borrowers and contractors involved in the construction of Rural Development financed RRH properties are required to maintain recordkeeping systems which establish accounts that categorize costs in conformity with sections 1924.13 (e) (1) (v) (A) and 1924.13 (e) (2) (i) (H) of Rural Development Instruction 1924-A. *Form RD 1924-13* includes a certification that the cost of labor, materials, and other necessary services incurred during construction are accurate and fairly presented.

Borrowers are required to comply with laws, regulations, and Rural Development procedures related to the construction of RRH properties. USDA Office of Inspector General audits have identified borrowers that received builder's profit for being the general contractor when, in fact, general contractor responsibilities were being performed by other contractors. The audits also disclosed that some identity-of-interest companies were merely "shell" companies with no employees, inventory, or other business activities. Other identity-of-interest companies have charged rental fees for equipment use for the entire construction period when the equipment was actually used for short or intermittent periods during construction.

These actions have resulted in significant amounts of overcharges to RRH properties. Sections 1924.13 (e) (1) (v) (H) and 1924.13 (e) (2) (viii) of Rural Development Instruction 1924-A prohibit borrowers from receiving builder's profit for acting as the general contractor if more than 50 percent of the property is subcontracted to one subcontractor or 75 percent to three or fewer subcontractors. Sections 1924.13 (e) (1) (I) and 1924.13 (2) (viii) of Rural Development Instruction 1924-A require that before a borrower can claim expenses paid to an identity-of-interest company, it must also provide services and/or materials to the general public and not just to RRH properties.

Agreed-Upon Procedures

1. Compare the total amount paid through the construction checking account (by adding the total amount from monthly statements) to the total amount of costs reported on *Form RD 1924-13*. Report any differences.

2. Examine selected checks, invoices, job cost ledgers, receiving documentation, etc., that support costs presented on *Form RD 1924-13* to ensure they were actually incurred to construct the project. (Note: Verify that checks have been cancelled and ensure that indirect costs are not included with the cost of labor and materials on *Form RD 1924-13*.)

3. Inspect selected checks held as retainage from subcontractors for evidence that they were actually paid by the bank. Confirmation with subcontractors may be necessary if cancelled checks are not available or not cancelled by the bank. (Note: Office of Inspector General audits have disclosed instances where checks were made to subcontractors, but never cashed.)

4. Compare the address on selected delivery documents and invoices (using the sample from audit step II.A.2.) to the project's address to ascertain whether materials and services were provided to the project under review. (Note: Office of Inspector General audits have disclosed instances where delivery was not made to the RRH project site.)

5. Examine selected cancelled checks related to accounts included in the "to be paid" column of *Form RD 1924-13* to determine the propriety of the costs reported. (Note: Office of Inspector General audits have disclosed instances where these costs were invoiced by identity-of-interest companies, but were never actually paid by the borrower.)

6. Confirm payments with selected subcontractors and material suppliers and investigate any discrepancies. (Note: Be alert for any discounts, rebates, or refunds that were provided to the contractor but not included on *Form RD 1924-13*.)

7. Inspect selected bid documentation to verify that the lowest bid submitted was accepted. If the lowest bid was not accepted, evaluate the justification for the higher bid. If documentation does not exist, report this and the reason why as a finding. (Note: Be alert for "sweetheart contracts" and contracts to disclosed or undisclosed identity-of-interest companies.)

8. Compare selected subcontractor billings (invoices) to contract amounts. If billings were in excess of contractual terms, ascertain the reason for the higher expense.

9. Obtain the number of subcontractors used during construction and calculate the percentages of subcontractors to ensure compliance with Rural Development requirements.[1]

10. Examine selected accounting records for undisclosed identity-of-interest companies. The practitioner should focus on transactions involving the use of one or two contractors/subcontractors, or if one contractor/subcontractor provided a significant percentage of materials or services.

11. Determine if identity-of-interest companies meet Rural Development requirements[2] of providing services to the general public.

    a. Question the general contractor/borrower about the business activities of any identity-of-interest company used and request evidence that the company provides services or materials to the general public.

    b. Review identity-of-interest records (e.g., sales records, invoices, receiving documents, etc.).

    c. Confirm by independent verification that identity-of-interest companies exist and provide services to the general public. (Note: This evidence could include listings in a telephone directory, advertisement to the public, etc. Also, be alert for “shell” companies that exist solely for processing invoices and adding markups to the original supplier’s invoices. Markups made by identity-of-interest companies that do not provide services/supplies to entities other than the RRH property are not allowable.)

12. Compare equipment rental and supervision charges by identity-of-interest companies to independent rental companies to determine reasonableness[3] of charges. Report any significant variances.

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[1] Sections 1924.13 (e) (1) (v) (h) and 1924.13 (2) (2) (viii).

[2] Sections 1924.13 (e) (1) (I) and 1924.13 (2) (viii).
[3] A charge would be considered reasonable if it is approximately the same amount of cost that a non identity-of-interest company would charge.

a. Question the borrower about the use of equipment during construction and how rental rates were established and time of use determined.

b. Contact an independent rental company to determine commercial rental rates and compare them to the identity-of-interest charges.

c. Examine borrower documentation (e.g., commercial rate lists, time sheets, construction schedules, etc.) to support the rates that were used and time that was charged for equipment rental fees. (Note: Office of Inspector General audits have disclosed that borrowers are charging rental fees when equipment is not in use.)

d. Question the borrower about supervision charges.

e. Verify that the borrower has documentation (e.g., timesheets or timecards, travel reports, payroll records, etc.) to support supervision charges.

III. ANNUAL AGREED-UPON PROCEDURES ENGAGEMENTS

A. AGREED-UPON PROCEDURES FOR THE ANNUAL ATTESTATION ENGAGEMENT

The Office of Inspector General has identified significant fraud and abuse of operating and maintenance expenses in the RRH Program. The procedures in this section are designed to assist practitioners in identifying ineligible charges and misused funds reported on *Form RD 3560-7*, Part II, Operating and Maintenance Expense Schedule and Part III Account Budgeting/Status. RD Regulation 3560 provides requirements for owners and management companies participating in the RRH Program, particularly those involving identity-of-interest companies. The procedures in this section are designed to identify noncompliance with these requirements.

The most common occurrence involves identity-of-interest companies that are merely "shell" companies with no employees, inventory, or other business activities. In these instances, owners and management companies use identity-of-interest companies to inflate costs from legitimate vendors or bill the properties directly for work that was never performed. While Rural Development requires the disclosure of identity-of-interest companies, many owners and management companies fail to comply with this requirement.

Agreed-Upon Procedures

1. Compare the total amount paid from the operating and maintenance bank account (by adding the total amount from monthly statements) to the total amount of costs reported on the general ledger and *Form RD 3560-7*. Part II.

2. Examine selected receipts, invoices, cancelled checks, etc., that support operating and maintenance expenses presented on *Form RD 3560-7*, Part II, to ensure they were actually incurred during the ongoing operations of the project. The practitioner should focus on line items 1-10, and 19-32. (Note: Do not accept photocopies of receipts or invoices and be alert for invoices that appear to be altered, have duplicate invoice numbers, or that are not pre-printed.)

3. Compare selected operating and maintenance records pertaining to expenses on *Form RD 3560-7*, Part II, to Rural Development regulations for eligibility and reasonableness. Practitioners should use professional judgment in determining the reasonableness of charges.

4. Confirm payments with selected vendors for maintenance and operating expense items (or any questionable charges) from *Form RD 3560-7*, Part II. (Note: Discounts, rebates, or refunds should be credited to the property's account.)

5. Confirm with the financial institution year-end reserve account balances on *Form RD 3560-7*, Part III, and that there are no encumbrances of reserve account funds.

6. Calculate the number of reserve account withdrawals from bank statements. This number is to be included in the engagement report. (Note: Original bank statements should be used for this analysis and be alert for transfers and automatic withdrawals from the reserve account.)

7. Examine the caretaker agreement for compliance with Rural Development requirements[4]. (Note: Office of Inspector General audits have disclosed instances where caretaker duties included services paid for in the management fee.)

8. Examine documents to confirm that owners/management companies solicited bids from independent companies for services/materials that were provided by identity-of-interest companies.

9. Determine who owns selected contractor companies from the applicable State agency (for example Secretary of State records) and compare to RRH project owner and management company ownership names to uncover undisclosed identity-of-interest companies.

10. Compare the address on selected work orders, delivery documents, invoices, remittance notices, etc., to the RRH project address to ensure that services/supplies were provided to the appropriate property.

11. Confirm by independent verification that identity-of-interest companies exist and provide services to the general public. (Note: The evidence could include listing in a telephone directory, advertisement to the public, etc. Also, be alert for “shell” companies that exist solely for processing invoices and adding markups to the original supplier’s invoices. Markups made by identity-of-interest companies that do not provide services/supplies to entities other than RRH property are not allowable.)

[4] RD Regulation 3560.102(b)(1)(ii)

Illustrative Auditor's Agreed-Upon Procedures Report

(*Form RD 1924-13* or *Form RD 3560-7*)

To the Owners and Management Company of *(name of RRH project, city and State)* and the project's financial accounts:

We have performed the procedures enumerated below, which were agreed to by Rural Development and the owner of *(name of RRH project, city and State)* and the project's financial accounts, solely to assist those parties in evaluating the accompanying (*Form RD 3560-7, Multiple Family Housing Project Budget* or *Form RD 1924-13, Estimate and Certificate of Actual Cost*) prepared in accordance with the criteria specified in Rural Development Regulations 1924 and 3560 for the year ended December 31, *(applicable year)*. The owner is responsible for *(name of the RRH project)* financial accounts. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in Government Auditing Standards issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of Rural Development. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The agreed-upon procedures performed during this engagement were included in the audit program designed for the Rural Rental Housing Program dated September 29, 2004. The findings for each of the agreed-upon procedures are as follows.

(Agreed –Upon Procedure No.) *(Finding)*
(Agreed –Upon Procedure No.) *(Finding)*
(Agreed –Upon Procedure No.) *(Finding)*
(etc)

We were not engaged to and did not conduct an audit, the objective of which would be the expression of an opinion on the financial statements of *(name of RRH project, city and State)*. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the owner and management company of *(name of RRH project, city and State)*, and Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

(Signature)

(DATE)

Attachment 4-C
Performance Standards
Borrower Self-Certification Letter

Date

USDA Rural Development Office
Address
Address

In accordance with the criteria specified in Section 5; Paragraph 4.32 C. of the USDA Rural Development Handbook (HB-2-3560) for the year ended ***DATE, YEAR***, the borrower must self-certify that ***PROJECT NAME*** is in compliance with the nine performance standards. The following is a summary of our compliance with the performance standards.

1. The required accounts are *(are not)* properly maintained and tracked separately. The accounts we maintain are marked below:

   __ Operating Account(s) __ Security Deposit Account
   __ Tax & Insurance Account __ Reserve Account
   __ Other Accounts: ____

2. The payments from operating account(s) are *(are not)* disclosed and accurately represented.

3. The reserve account(s):

   a. is on *(not on)* schedule with the Agency required minimum funding requirements;
   b. is *(is not)* maintained in a supervised bank account that requires the Agency's countersignature on all withdrawals;
   c. is on *(not on)* schedule with contributions to the reserve account for the current year with the Agency required minimum funding; and
   d. has no *(has)* encumbrances on the reserve funds.

4. The tenant security deposits accounts are *(are not)* fully funded and are (*are not)* maintained in separate accounts.

5. The payment of owner return was:

   __ paid in the amount of $_____ for 20XX fiscal year and was (was not) in accordance with the Agency's requirements OR
   __ not paid during the reporting year OR
   __not allowable due to our nonprofit status OR

__not allowable due to our nonprofit status. However, an asset management fee in the amount of $_____ was paid for 20XX fiscal year.

6. The borrower has *(has not)* maintained proper insurance in accordance with the requirements in 7 CFR 3560.105. Coverage maintained for ***PROJECT NAME*** is as follows:

   __ Liability Insurance   __ Flood Insurance
   __ Property Insurance   __ Earthquake Insurance
   __ Fidelity Bond   __ Other: ____________________

7. All financial records are *(are not)* adequate and suitable for examination.

8. There have been no changes in the ownership of ***PROJECT NAME***, other than those approved by the Agency and identified in the certification. ***For non-profit borrowers:*** The Board of Directors is *(is not)* active and maintains oversight responsibilities for the project.

9. The real estate taxes (property taxes) are paid in accordance with state and/or local requirements. As of ***YEAR END DATE,*** there are no delinquent real estate taxes (property taxes).

I certify that the above is true, accurate and is properly supported by documentation kept in our files.

[Signature of GP or Mgmt Agent]

PRINTED SIGNATURE
BORROWER NAME

NOTE TO BORROWER: *If the project is not in compliance with any of the above Performance Standards, you must state that you are not in compliance with the standard and provide the Agency with a statement about the non-compliance and the methods taken to correct the non-compliance.*

Attachment 4-D
Agreed-Upon-Procedures and Determinations
(Projects with 16 units or More)

1.) Examine selected receipts, invoices, cancelled checks, (or check imaging on original bank statement) etc. that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project.

a. Testing Criteria: Examine the documents in step 1c for the following characteristics:
   i. Existence of invoice and agreement in transaction amount.
   ii. No evidence of alteration of the invoice or duplicate invoice numbers.
   iii. Agreement of shipping/work address and project address or name.
   iv. Examine invoice descriptions of product or services for non-eligible expenses by comparing the expenses to the Attachment 4-A of HB-2-3560.
   v. Select a representative sub-sample of invoices from step 1b to confirm. The sub-sample should represent a minimum of 10 percent of the dollar value of the original sample selected in step 1b. (***Note:*** Discounts, rebates, or refunds should be credited to the property's account.)

b. Sample Selection Methodology (*required for each individual project*): The CPA will select a representative sample, based on the following schedule, disbursements in the general ledger for all accounts includable in lines 1-10 and 19-32 of Form RD 3560-7 during the reporting period. The sample testing period and methodology will be determined based on auditors' judgment.

Sample Size Determination Schedule:

Units	Sample Size
24 or Less	10
25 - 48	15
49 - 99	20
100 or more	25

c. Acceptable Supporting Documentation: Obtain and examine the following supporting documents for each of the selected transactions from step 1b:
   i. Cancelled check (or check imaging on original bank statement) or applicable charges on bank statements; and
   ii. Original third party vendor invoices.

d. Reporting Requirements: The CPA's report should agree in form and content to the sample AUP report in Attachment 4-F in RD HB-2-3560. At a minimum, the following information should be disclosed:
   i. Population size of lines 1-10 and 19-32 of Form RD 3560-7 defined in terms of total dollar value and in terms of number of transactions.

ii. Sample size selected in step 1b defined in terms of total dollar value and in terms of number of transactions.
iii. Sub-sample size selected in 1a(v) defined in terms of total dollar value and in terms of number of transactions.
iv. Exceptions should be disclosed for steps 1a(i) through 1a(v). Exceptions should be reported both in terms of the number of transactions with exceptions and the total dollar value associated with each exception.

2.) Confirm the balance in the replacement reserve account presented on Form RD 3560-7, Part III and confirm that no amounts were encumbered by the financial institution that holds the accounts. Determine that all balances are within the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC) insurance limits, as applicable. Determine that the total withdrawals from the bank statements agree to the total withdrawals authorized by Rural Development on Form RD 3560-12. Compare the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals.

a. Testing Procedures:
   i. Confirm replacement reserve account balance at period end with appropriate financial institution(s) and agree to general ledger balance(s). Request financial institutions provide a positive confirmation of no encumbrances on replacement reserve account balances to their knowledge.
   ii. Determine that each replacement reserve account withdrawal in the original bank statements agrees to Form RD 3560-12 for the engagement period.
   iii. Examine supporting invoices and cancelled checks (or check imaging on original bank statement) for replacement reserve withdrawals for evidence that the funds were paid to the authorized vendors.

b. Acceptable Supporting Documentation: Obtain and examine the following supporting documents for each of the procedures outlined in 2a:
   i. Original bank statements;
   ii. Request for Authorization to Withdraw Reserve Funds (Form RD 3560-12) sign/approved by Rural Development;
   iii. Signed and completed financial institution confirmation form; and
   iv. FIN 2100 project reserve account checkbook.

c. Reporting Requirements: The CPA's report should agree in form and content to the sample AUP report in Attachment 4-F in RD HB-2-3560. At a minimum, the following information should be disclosed:
   i. Replacement reserve account balance; confirmed by the financial institution and agrees to the bank reconciliation.
   ii. The amount of any encumbrances reported by financial institutions in step 2a(i).
   iii. Amount of any replacement reserve account balances exceeding FDIC or SIPC insurance limits.
   iv. Number and value of replacement reserve account withdrawals from the original bank statements.
   v. Number and value of replacement reserve account withdrawals approved by Rural Development.
   vi. Number and value of transactions that were not for authorized purposes.

3.) Obtain an Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determine that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project.

a. Testing Procedures:
    i. Obtain a listing of all IOI companies for the project from the Rural Development office.
    ii. For each IOI company, examine a sample of invoices to determine that the expenses for the approved services on Form RD 3560-31 are what is being charged to the project.
    iii. As part of the AUP engagement, consider whether or not any undisclosed IOI companies were incidentally disclosed during the engagement.

b. Sample Selection Methodology: The CPA will test a minimum of 10% of the total invoices for each IOI company by selecting a representative sample.

c. Acceptable Supporting Documentation: Obtain and examine the following supporting documents for each of the procedures outlined in 3a:
    i. Form RD 3560-31 for each IOI company;
    ii. A schedule of amounts paid to each IOI company;
    iii. IOI invoices;
    iv. Inquiries of management and ownership; and
    v. Management Representation Letter.

d. Reporting Requirements: The CPA's report should agree in form and content to the sample AUP report in Attachment 4-F in RD HB-2-3560. At a minimum, the following information should be disclosed:
    i. The number of IOI companies.
    ii. The total expenses incurred with the IOI companies for the engagement period.
    iii. Population size defined in terms of total dollar value and in terms of number of transactions.
    iv. Sample size selected in step 3b defined in terms of total dollar value and in terms of number of transactions.
    v. Exceptions should be disclosed for steps 3a(i) through 3a(iii). Exceptions should be reported both in terms of the number of transactions with exceptions and the total dollar value associated with each exception.
    vi. State whether or not any IOI companies were found, in conjunction with our AUP engagement and Audit (if applicable), or in management's Representation Letter which among other items asserts management's representation and responsibility for disclosing all IOI companies, that were not reported to Rural Development on Form RD 3560-31.

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Attachment 4-E
Example Engagement Letter
(Projects with 16-23 Units)

Date, Year

Name
COMPANY NAME
Address
City, State Zip

We are pleased to confirm our understanding of the nature and limitations of the services we are to provide for each Rural Development Apartment Community ("Project") owned by the entities detailed in Exhibit B.

We will apply the agreed-upon-procedures which you and United States Department of Agriculture Rural Development personnel have specified as listed in the attached Exhibit A, to information included in Forms RD 3560-7 and 3560-10. These engagements are solely to assist the Owners and Rural Development in evaluating that Forms RD 3560-7 and 3560-10 are prepared in accordance with the criteria specified in 7 CFR Part 3560, Section 303(b) and Section 306 in accordance with the determinations noted in Attachment 4-D of RD Handbook HB-2-3560, for the year ending ***DATE, YEAR.***

Our engagement to apply agreed-upon procedures will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The sufficiency of the procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Exhibit A either for the purpose for which this report has been requested or for any other purpose. If, for any reason, we are unable to complete the procedures for a particular project(s), we will describe any restrictions on the performance of the procedures in our respective report, or will not issue a report as a result of this specific engagement.

Because the agreed-upon procedures listed in Exhibit A do not constitute an examination, we will not express an opinion on Forms RD 3560-10 and 3560-7. In addition, we have no obligation to perform any procedures beyond those listed in Exhibit A.

We will submit our report for each of the projects in Exhibit B listing the procedures performed and our findings. The report is intended solely for the use of the project's owners, the management agent and Rural Development, and should not be used by anyone other than these specified parties, and take responsibility for the sufficiency of the procedures for their purposes. Our report will contain a paragraph indicating that had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

At the conclusion of each engagement, we will require a representation letter from the owner and or management of each specific Project that, among other things, will confirm management's responsibility for the presentation of Forms RD 3560-7 and 3560-10 in accordance with the criteria specified in 7 CFR part 3560 Section 303(b) and 7 CFR part 3560 Section 306, in accordance with the determinations noted in Attachment 4-D of the RD Handbook HB-2-3560, for the year ending ***DATE, YEAR*** and management's responsibility for compliance with the requirements of 7 CFR part 3560 Sections 308(a), 308(b) and 308(c).

As part of our engagement, we will also prepare federal and state income tax returns for the entities listed in the attached Exhibit B for the year ended ***DATE, YEAR.*** You are responsible for the decisions and functions of your property, and for designating a competent employee to oversee these services. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for the results. You are also responsible for establishing and maintaining internal controls, including monitoring ongoing activities. You should be aware that, under the Internal Revenue Service Restructuring and Reform Act of 1998, certain information discussed by you with members of our firm who are authorized tax practitioners or their agents for the purpose of obtaining our firm's advice on tax matters is privileged from disclosure in any non-criminal tax matters before the IRS. Information compiled for the purpose of preparing a tax return is not privileged under common law because it is intended for disclosure to the IRS or others. The privilege will be waived if the communication is voluntarily disclosed to a third party. Professional standards require us to discuss matters that may affect the engagement with our firm personnel responsible for non-attest services, which includes tax services. The IRS might not take the position that such communication results in a waiver of privilege.

During the course of our engagements, we shall request information and explanations from the owner and/or management regarding the respective entity's operations, internal controls, compliance matters, future plans, specific transactions, and accounting system and procedures. We understand that your employees will prepare all cash, vendor, accounts payable and other confirmations we request and will work with our staff to locate any documents selected by us for testing. We will request written confirmation from financial institutions as part of each engagement, and they may bill you for responding to that inquiry. At the conclusion of each engagement, we will require, as a precondition to the issuance of our report, that management reconfirm this information in a written representation letter. The procedures which we will perform in our engagements will be heavily influenced by the representations that we receive from you and/or management. Accordingly, false representations could cause us to expend unnecessary efforts or could cause a material error or a fraud to go undetected by our procedures. You acknowledge that as a condition of our agreement to perform the engagements, you and all members of your management, agree to the best of your knowledge and belief to be truthful, accurate, and complete in the representations you make to us during the course of the engagements and in the written representations provided to us at the completion of the engagements. In view of the foregoing, you agree that we shall not be responsible for any misstatements in the agreed-upon procedures report as a result of false or misleading representations that are made to us by you or your management. In addition, because our failure to detect material misstatements could cause others relying upon our report to incur damages, you and management further agree to indemnify and hold us harmless for any liability and all reasonable costs (including legal fees) that we may incur in connection with claims based upon our failure to detect material misstatements in the respective entity's agreed-upon procedures report resulting from false or misleading representations made to us by you or any member of your management.

____

Management is responsible for evaluating adequacy and results of those procedures and accepting responsibility for such procedures. Management is responsible for establishing and maintaining internal controls, including monitoring ongoing activities. Management is responsible for management decisions and functions, and for designating a qualified management-level employee to oversee our performance of the non-attest services. As part of our engagements:

We will not perform any management functions or make management decisions.

We will assist you and/or management in the calculation of depreciation expense and maintenance of fixed asset and depreciation records, however, you and/or management shall be responsible for determining the depreciation method, rate and life of each class of assets and determining salvage value, if any. You and/or management shall be solely responsible for the completeness and accuracy of the related fixed asset and depreciation schedules.

We will prepare a general ledger trial balance for use during each engagement. Our preparation of the trial balance will be limited to formatting information in the respective entity's general ledger into a working trial balance.

The documentation for these engagements is the property of ***CPA FIRM NAME*** and constitutes confidential information. However, we may be requested to make certain documentation available to the United States of America acting through Rural Development, the Office of Inspector General (OIG) and the Government Accountability Office (GAO) or their representatives, pursuant to authority given to them by law or regulation. We will notify you of any such request. If requested, access to such documentation will be provided under the supervision of ***CPA FIRM NAME*** personnel. Furthermore, upon request, we may provide copies of selected documentation to Rural Development, OIG or GAO representatives. Rural Development, OIG and GAO may decide to distribute the copies or information contained therein to others, including other governmental agencies. We may also be requested to make certain documentation available to the investment partner(s)/member(s) or their representatives pursuant to authority given to them by the Partnership/Operating Agreement. Access to such documentation will be provided under the supervision of ***CPA FIRM NAME***. Furthermore, upon request, we may provide photocopies of selected documentation to the investment partner(s)/member(s) or their representatives and they may decide to distribute the photocopies or information contained therein to others, including governmental agencies.

You may request that we perform additional services not contemplated by this engagement letter. If this occurs, we will communicate with you regarding the scope of the additional services and the estimated fee. We also may issue a separate engagement letter covering the additional services. In the absence of any other written communication from us documenting such additional services, our services will continue to be governed by the terms of this engagement letter.

Our fees for these services are based upon the actual time spent at our standard hourly rates, travel, and other out-of-pocket costs such as report production, word processing, postage, etc. Our standard hourly rates vary according to the degree of responsibility involved and the experience level of the personnel assigned to your engagements. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the engagements. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs. Our invoices for each engagement will be rendered as work progresses and is payable on presentation.

Based on our preliminary estimate, the fees for the engagements will be as detailed in Exhibit B. In accordance with our firm policies, work may be suspended if your account becomes ***XX*** days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, each engagement will be deemed to have been completed upon written notification of termination, even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination. The suspension or termination of our work may result in adverse consequences to you including the failure to meet deadlines imposed by governments, lenders, or other third parties. You agree that we will not be responsible for your failure to meet such deadlines, or for penalties or interest that may be assessed against you resulting from such failure.

Government Auditing Standards require that we provide you with a copy of our most recent external peer review report and any letter of comment. Our peer review report accompanies this letter.

We appreciate the privilege and opportunity to work with you and your staff during the completion of this important engagement. If the engagement letter terms are acceptable and in accordance with your understanding of our engagement, please sign the attached agreement and return it to us. Please retain the original letter and the client copy of the agreement page for your files. If you have any questions or comments regarding the terms of this engagement letter, please do not hesitate to contact us.

Very truly yours,

CPA FIRM NAME
Certified Public Accountants

EXHIBIT A
Schedule of Agreed-Upon Procedures:

1.) Examine selected receipts, invoices, cancelled checks, (or check imaging on original bank statement) etc. that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project.

2.) Confirm the balance in the replacement reserve account presented on Form RD 3560-7, Part III and confirm that no amounts were encumbered by the financial institution that holds the accounts. Determine that all balances are within the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC) insurance limits, as applicable. Determine that the total withdrawals from the bank statements agree to the total withdrawals authorized by Rural Development on Form RD 3560-12. Compare the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals.

3.) Obtain an Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determine that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project.

EXHIBIT B

Entity and Fee Schedule
Year Ended *DATE, YEAR*

ENTITY NAME	CONTRACT

CPA FIRM NAME **SERVICE AGREEMENT**

Agreement to report on Rural Development Agreed-Upon Procedures and to prepare Federal, State & Local tax reporting forms on each of the Rural Rental Housing Apartment Communities for the entities listed in the attached Exhibit B managed by *COMPANY NAME* as outlined in the *CPA FIRM NAME* engagement letter dated *Date, Year*.

To accept the Schedule of fees in Exhibit B and the terms as stated in the attached engagement letter:

- Sign below,
- Return this page to us,
- Retain the original engagement letter and a copy of this letter for your files.

By: ______________________________________ Date:______________
(Signature)

____
(Name, Printed)

____
(Title)

Client Copy

CPA FIRM NAME SERVICE AGREEMENT

Agreement to report on Rural Development Agreed-Upon Procedures and to prepare Federal, State & Local tax reporting forms on each of the Rural Rental Housing Apartment Communities for the entities listed in the attached Exhibit B managed by *COMPANY NAME* as outlined in the *CPA FIRM NAME* engagement letter dated *Date, Year*.

To accept the Schedule of fees in Exhibit B and the terms as stated in the attached engagement letter:

- Sign below,
- Return this page to us,
- Retain the original engagement letter and a copy of this letter for your files.

By: ____ Date:_______________
(Signature)

____
(Name, Printed)

____
(Title)

Please Sign and Return This Page Along with the Attached Exhibit B

Entity and Fee Schedule
Year End DATE, YEAR

ENTITY NAME	CONTRACT

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Attachment 4-F
Example Report
(Projects with 16-23 Units)

ANYTOWN APARTMENTS LIMITED PARTNERSHIP

AGREED-UPON PROCEDURES
DATE, YEAR

ANYTOWN APARTMENTS LIMITED PARTNERSHIP
DBA ANYTOWN APARTMENTS
DATE, YEAR

CONTENTS

Independent Accountants' Report on Applying Agreed-Upon Procedures

To the Partners of
Anytown Apartments Limited Partnership
DBA Anytown Apartments
City, State

and

United States Department of Agriculture
Rural Development
Servicing Office
City, State

We have performed the procedures enumerated below, which were agreed to by the United States Department of Agriculture Rural Development and Anytown Apartments Limited Partnership ("Owner") the owner of Anytown Apartments ("Project") located in City, State, solely to assist those parties in evaluating that the accompanying Form RD 3560-10, Multiple Family Housing Borrower Balance Sheet, Form RD 3560-7, Multiple Family Housing Project Budget ("Financial Reports") and Supporting Documentation are prepared by the Borrower in accordance with the criteria specified in RD Regulations contained in 7 CFR 3560 section 303(b) and section 306, in accordance with the determinations noted in Attachment 4-D of RD Handbook HB-2-3560, for the year ended DATE, YEAR. The owner is responsible for the presentation of the financial reports. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of RD and the owner. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. We examined selected receipts, invoices, and cancelled checks (or check imaging on original bank statement) that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project. We selected a representative sample of invoices and supporting documentation, based on the sample size determined by RD in Attachment 4-D of RD Handbook HB-2-3560, for expenses included in Lines 1-10 and 19-32 of Form RD 3560-7 and determined that the services were eligible expenses, in accordance with Attachment 4-A of HB-2-3560, and the shipping address agreed to the project address. In addition, we confirmed a sample of the expenditures with the vendors to determine the invoice paid agreed to the vendor's records.

Findings:

Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:
Total Number of Invoices in Vendor Confirmation Sample:
Total Dollar Amount of Invoices in Vendor Confirmation Sample:
Total Number of Vendor Confirmations Not Received:
Total Dollar Amount of Vendor Confirmations Not Received:
Total Number of Deviations:
Total Dollar Amount of Deviations:

Note: *The CPA should provide enough detail for any deviations, that the user of the report would understand why the deviation is present.*

2. We confirmed the balance in the replacement reserve account presented on Form RD 3560-7, Part III, and confirmed that no amounts were encumbered by the financial institution that holds the accounts. We determined that all balances are within the FDIC insurance limits. We determined number of reserve account withdrawals from the original bank statements and compared the withdrawals to the amounts approved by Rural Development on Form RD 3560-12. We compared the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals from Rural Development.

Findings:

Total Number of Reserve Account Withdrawals:
Total Number of Withdrawals Authorized by Rural Development:
Total Dollar Amount of Reserve Account Withdrawals:
Total Dollar Amount of Withdrawals Authorized by Rural Development:
Total Number of Deviations:
Total Dollar Amount of Deviations:

The confirmation received from the financial institution agreed to the project's bank reconciliation and no encumbrances were noted on the confirmation. All withdrawals were paid to the vendors approved by Rural Development on Form RD 3560-12.

3. We obtained the Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determined that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project. We examined a sample of invoices and determined that the services and charges are in accordance with the disclosures contained in Form RD 3560-31 as agreed to by Rural Development.

Findings:

Total Number of Forms RD 3560-31 Received:

Company Name 1:
Total Dollar Amount for the Year:
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Company Name 2:
Total Dollar Amount for the Year:
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

The agree-upon procedures performed above and the management Representation Letter revealed no undisclosed IOI companies.

Note: *If an IOI Company performs more than one service for the project, the CPA should identify each service and fees associated with that service separately. Rural Development wants information that they can tie back to the Form RD 3560-7 and their internal IOI tracking procedures. For example:*

ABC Management Co.

Management Fees
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Bookkeeping Fees
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Payroll / Employee Benefits Reimbursement
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the financial reports and supporting documentation of Anytown Apartments. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the owner and management agent of Anytown Apartments, and Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

CPA FIRM NAME
Certified Public Accountants
DATE,

SUPPORTING DOCUMENTATION

INCLUDE FORMS RD 3560-7 AND 3560-10

1. Accounts Receivable (Form RD 3560-10, Line 7)

Accounts Receivable - Rental Subsidy	$ -	
Accounts Receivable - Tenants	-	
Accounts Receivable - Other	-	$ -

2. Notes Payable (Form RD 3560-10, Line 23)

Accrued Mortgage Interest	$ -	
Accrued Real Estate Taxes	-	
Prepaid Rents	-	$ -

3. Other (Form RD 3560-10, Line 27)

Due to Partners		$ -

4. Miscellaneous (Form RD 3560-7, Line 27)

Bad Debts	$ -	
Other	-	$ -

5. Accrual to Cash Adjustment (Form RD 3560-7, Line 32)

Assets		
Accounts Receivable	$ -	
Accounts Receivable - Other	-	
Prepaid Expenses	-	
Security Deposits	-	
Liabilities		
Accounts Payable - Trade	-	
Accrued Real Estate Taxes	-	
Security Deposits & Prepaid Rents	-	
Other Adjustments		
2007 Mortgage Payment made in 2006	-	$ -

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Attachment 4-G
Example Engagement Letter
(Projects 24 Units or more)

Date, Year

Name
Company Name
Address
City, State Zip

We are pleased to confirm our understanding of the nature and limitations of the services our firm will provide for each of the Entities detailed in Exhibit B.

We will perform an audit of the balance sheet as of ***DATE, YEAR***, and the related statements of operations, changes in partners' equity and cash flows for the year then ended. Also, the supplementary financial information required by the *United States Department of Agriculture RD Handbook HB-2-3560* listed below will be subjected to the auditing procedures applied in our audit of the financial statements:

- Calculation of Management Fee
- Return to Owner
- Insurance Detail

The objective of our audit is the expression of an opinion about whether the financial statements are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America and to report on the fairness of the supplementary information referred to in the second paragraph when considered in relation to the financial statements taken as a whole. The objective also includes reporting on each Entity's internal controls and its compliance with certain provisions of laws, regulations, contracts, and grant agreements in conformity with auditing standards generally accepted in the United States of America and as required by *Government Auditing Standards* and the *United States Department of Agriculture RD Handbook HB-2-3560*. Our audit will be conducted in accordance with auditing standards generally accepted in the United States of America, the standards for financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and the *United States Department of Agriculture RD Handbook HB-2-3560.*

Our audit will include tests of the accounting records of each Entity and other procedures we consider necessary to enable us to express such an opinion and render the required reports. If our opinion is other than unqualified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or to issue a report as a result of this engagement.

The report on internal control and compliance will include a statement that the report is intended for the information and use of the partner, management, others within the organization and the United States Department of Agriculture Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

The management of each Entity is responsible for establishing and maintaining effective internal control and for compliance with the provisions of applicable laws, regulations, contracts, and grant agreements. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of the controls. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, that transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that Rural Development programs are managed in compliance with applicable laws and regulations and the provisions of contracts and grant agreements.

In planning and performing our audits, we will consider the internal control sufficient to plan each audit in order to determine the nature, timing, and extent of our auditing procedures for the purpose of expressing our opinions on the Entity's financial statements and on its compliance with specific requirements applicable to its Rural Development programs and to report on the internal control in accordance with the provisions of *Government Auditing Standards* and not to provide any assurance on the internal control.

We will obtain an understanding of the design of relevant controls and whether they have been placed in operation, and we will assess control risk. Tests of controls may be performed to test the effectiveness of certain controls we consider relevant to preventing and detecting errors and fraud that are material to the financial statements and to preventing and detecting misstatements resulting from illegal acts and other noncompliance matters that have a direct and material effect on the financial statements. (Tests of controls are required only if control risk is assessed below the maximum level.) Our tests, if performed, will be less in scope than would be necessary to render an opinion on internal control and, accordingly, no opinion will be expressed in our report on internal control issued pursuant to *Government Auditing Standards*.

We will perform tests of controls over compliance, as required by *Government Auditing Standards* and the *United States Department of Agriculture RD Handbook HB-2-3560*, to evaluate the effectiveness of the design and operation of controls that we consider relevant to preventing or detecting material noncompliance with specific requirements applicable to each Entity's Rural Development programs.

Our tests will be less in scope than would be necessary to render an opinion on these controls and accordingly, no opinion will be expressed.

Our audit will include obtaining an understanding of internal control sufficient to plan each audit and to determine the nature, timing, and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify deficiencies in internal control. However, during the audit, we will communicate to you internal control related matters that are required to be communicated under professional standards.

Identifying and ensuring that each Entity complies with laws, regulations, contracts, and grant agreements is the responsibility of management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we will perform tests of each Entity's compliance with applicable laws and regulations, and the provisions of contracts and agreements, including grant agreements. However, the objective of those procedures will not be to provide an opinion on overall compliance and we will not express such an opinion.

Our audits will be conducted in accordance with the standards referred to in the third paragraph. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether material noncompliance with the requirements described in the *United States Department of Agriculture RD Handbook HB-2-3560* that are applicable to its Rural Development programs occurred. The purpose of each audit will be to express an opinion on each Entity's compliance with specific requirements applicable to major programs listed in the previous sentence.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the account, and may include direct confirmation of cash, investments, loan balances, and certain other assets and liabilities by correspondence with certain individuals, creditors and financial institutions. We may also request written representations from your attorneys as part of each engagement, and they may bill you for responding to that inquiry. At the conclusion of each engagement, we will require a written representation letter from the owner and or management of each specific Entity that, among other things, will confirm management's responsibility for the presentation of the financial statements.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audits will involve judgment about the number of transactions to be examined and the areas to be tested. Also, we will plan and perform the audits to obtain reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether from errors, fraudulent financial reporting, misappropriation of assets, or violations of laws or governmental regulations that are attributable to each Entity or to acts by management or employees on behalf of each Entity. Because the determination of abuse is subjective, *Government Auditing Standards* do not expect auditors to provide reasonable assurance of detecting abuse. As required by *Government Auditing Standards*, our audits will include tests of transactions related to federal awards programs for compliance with applicable laws and regulations and the provisions of contracts and agreements.

Because an audit is designed to provide reasonable, but not absolute, assurance and because we will not perform a detailed examination of all transactions, there is a risk that material misstatements or noncompliance may exist and not be detected by us. In addition, an audit is not designed to detect immaterial misstatements or violations of laws or governmental regulations that do not have a direct and material effect on the financial statements or on major programs. However, we will inform you, of any material errors and any fraudulent financial reporting or misappropriation of assets that comes to our attention. We will also inform you of any violations of laws or governmental regulations that come to our attention, unless clearly inconsequential. We will include such matters in the reports required for Rural Development audits. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

You are responsible for establishing and maintaining internal controls, including monitoring ongoing activities; for the selection and application of accounting principles; and for the fair presentation in the financial statements of financial position, changes in partners' capital, and cash flows in conformity with accounting principles generally accepted in the United States of America. You are also responsible for management decisions and functions; for designating a management-level individual with suitable skill, knowledge, or experience to oversee the tax services and any other non-attest services we provide; and for evaluating the adequacy and results of those services and accepting responsibility for them. As part of our engagements:

> We will not perform any management functions or make management decisions.
>
> We will assist you and/or management in the calculation of depreciation expense and maintenance of fixed asset and depreciation records, however, you and/or management shall be responsible for determining the depreciation method, rate and life of each class of assets and determining salvage value, if any. You and/or management shall be solely responsible for the completeness and accuracy of the related fixed asset and depreciation schedules.
>
> We will prepare a general ledger trial balance for use during each engagement. Our preparation of the trial balance will be limited to formatting information in the respective Entity's general ledger into a working trial balance.

We will also prepare federal, state and local income tax returns for the Entities listed in the attached Exhibit B for the year ended **DATE, YEAR**. You are responsible for the decisions and functions of your property, and for designating a competent employee to oversee these services. You are responsible for evaluating the adequacy and results of the services performed and accepting responsibility for the results. You are also responsible for establishing and maintaining internal controls, including monitoring ongoing activities. You should be aware that, under the Internal Revenue Service Restructuring and Reform Act of 1998, certain information discussed by you with members of our firm who are authorized tax practitioners or their agents for the purpose of obtaining our firm's advice on tax matters is privileged from disclosure in any non-criminal tax matters before the IRS. Information compiled for the purpose of preparing a tax return is not privileged under common law because it is intended for disclosure to the IRS or others. The privilege will be waived if the communication is voluntarily disclosed to a third party. Professional standards require us to discuss matters that may affect the engagement with our firm personnel responsible for non-attest services, which includes tax services. The IRS might not take the position that such communication results in a waiver of privilege.

Management is responsible for making all financial records and related information available to us, including any significant vendor relationships in which the vendor has the responsibility for program compliance. We understand that you will provide us with such information required for each audit and that you are responsible for the accuracy and completeness of that information. Management's responsibilities include adjusting the financial statements to correct material misstatements and for confirming to us in the management representation letter that the effects of any uncorrected misstatements aggregated by us during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Management is responsible for the design and implementation of programs and controls to prevent and detect fraud, and for informing us about all known or suspected fraud or illegal acts or illegal acts affecting each Entity involving management, employees who have significant roles in internal control, and others where the fraud or illegal acts could have a material effect on the financial statements. Your responsibilities include informing us of your knowledge of any allegations of fraud or suspected fraud or illegal acts affecting each Entity received in communications from employees, former employees, regulators, or others. In addition, management is responsible for identifying and ensuring that each Entity complies with applicable laws and regulations and for taking timely and appropriate steps to remedy any fraud, illegal acts, violations of contracts or grant agreements, or abuse that we may report.

As part of each audit, we will prepare a draft of your financial statements, supplementary financial information, and related notes. In accordance with *Government Auditing Standards*, you will be required to review and approve those financial statements prior to their issuance and have a responsibility to be in a position in fact and appearance to make an informed judgment on those financial statements. Further, you are required to designate a qualified management-level individual to be responsible and accountable for overseeing our services.

We will apply the agreed-upon-procedures which you and United States Department of Agriculture Rural Development personnel have specified as listed in the attached Exhibit A, to information included in Forms RD 3560-7 and 3560-10. These engagements are solely to assist the Owners and Rural Development in evaluating that Forms RD 3560-7 and 3560-10 are prepared in accordance with the criteria specified in 7 CFR Part 3560, Section 303(b) and Section 306 in accordance with the determinations noted in Attachment 4-D of RD Handbook HB-2-3560, for the year ending ***DATE, YEAR.***

Our engagement to apply agreed-upon procedures will be conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The sufficiency of the procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described in Exhibit A either for the purpose for which this report has been requested or for any other purpose. If, for any reason, we are unable to complete procedures for a particular project(s), we will describe any restrictions on the performance of the procedures in our respective report, or will not issue a report as a result of this specific engagement.

Because the agreed-upon procedures listed in Exhibit A do not constitute an examination, we will not express an opinion on the completeness of these procedures. In addition, we have no obligation to perform any procedures beyond those listed in Exhibit A.

We will submit our report for each of the Entities in Exhibit B listing the procedures performed and our findings. Each report is intended solely for the use of the project's owners, the management agent and Rural Development, and should not be used by anyone other than these specified parties, and take responsibility for the sufficiency of the procedures for their purposes. Our reports will contain a paragraph indicating that had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

At the conclusion of each engagement, we will require a representation letter from the owner and or management of each specific Entity that, among other things, will confirm management's responsibility for the presentation of Forms RD 3560-7 and 3560-10 in accordance with the criteria specified in 7 CFR part 3560 Section 303(b) and 7 CFR part 3560 Section 306, in accordance with the determinations noted in Attachment 4-D of the RD Handbook HB-2-3560, for the year ending DATE, YEAR and management's responsibility for compliance with the requirements of 7 CFR part 3560 Sections 308(a), 308(b) and 308(c).

During the course of each engagement, we shall request information and explanations from the owner and/or management regarding the respective Entity's operations, internal controls, compliance matters, future plans, specific transactions, and accounting system and procedures. We understand that your employees will prepare all cash, vendor, accounts payable and other confirmations we request and will work with our staff to locate any documents selected by us for testing. We will request written confirmation from financial institutions as part of each engagement, and they may bill you for responding to that inquiry.

At the conclusion of each engagement, we will require, as a precondition to the issuance of our report, that management reconfirm this information in a written representation letter. The procedures which we will perform in each engagement will be heavily influenced by the representations that we receive from you and/or management. Accordingly, false representations could cause us to expend unnecessary efforts or could cause a material error or a fraud to go undetected by our procedures. You acknowledge that as a condition of our agreement to perform each engagement, you and all members of your management, agree to the best of your knowledge and belief to be truthful, accurate, and complete in the representations you make to us during the course of each engagement and in the written representations provided to us at the completion of each engagement. In view of the foregoing, you agree that we shall not be responsible for any misstatements in the financial and compliance reports as a result of false or misleading representations that are made to us by you or your management. In addition, because our failure to detect material misstatements could cause others relying upon our report to incur damages, you and management further agree to indemnify and hold us harmless for any liability and all reasonable costs (including legal fees) that we may incur in connection with claims based upon our failure to detect material misstatements in the respective Entity's financial and compliance reports resulting from false or misleading representations made to us by you or any member of your management.

Management is also responsible to notify us in advance of your intent to print our reports in whole or in part, and to give us the opportunity to review any printed material containing our reports before its issuance.

The documentation for these engagements is the property of **CPA FIRM NAME** and constitutes confidential information. However, we may be requested to make certain documentation available to the United States Department of Agriculture acting through Rural Development, the Office of Inspector General ("OIG") and the Government Accountability Office ("GAO") or their representatives, pursuant to authority given to them by law or regulation. We will notify you of any such request. If requested, access to such documentation will be provided under the supervision of **CPA FIRM NAME** personnel. Furthermore, upon request, we may provide copies of selected documentation to Rural Development, OIG or GAO representatives. Rural Development, OIG and GAO may intend, or decide to distribute the copies or information contained therein to others, including other governmental agencies. We may also be requested to make certain documentation available to the investment partner(s)/member(s) or their representatives pursuant to authority given to them by the Partnership/Operating Agreement. Access to such documentation will be provided under the supervision of **CPA FIRM NAME**. Furthermore, upon request, we may provide photocopies of selected documentation to the investment partner(s)/member(s) or their representatives and they may intend, or decide to distribute the photocopies or information contained therein to others, including governmental agencies.

Each engagement ends on delivery of our financial and compliance reports. Any follow-up services that might be required will be a separate, new engagement. The terms and conditions of that new engagement will be governed by a new, specific engagement letter for that service.

Our fees for these services are based upon the actual time spent at our standard hourly rates, travel, and other out-of-pocket costs such as report production, word processing, postage, etc. Our standard hourly rates vary according to the degree of responsibility involved and the experience level of the personnel assigned to each engagement. Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. In accordance with our firm policies, work may be suspended if your account becomes XX days or more overdue and will not be resumed until your account is paid in full. If we elect to terminate our services for nonpayment, each engagement will be deemed to have been completed even if we have not completed our report. You will be obligated to compensate us for all time expended and to reimburse us for all out-of-pocket expenditures through the date of termination. The suspension or termination of our work may result in adverse consequences to you including your failure to meet deadlines imposed by governments, lenders, or other third parties. You agree that we will not be responsible for your failure to meet such deadlines, or for penalties or interest that may be assessed against you resulting from such failure. Based on our preliminary estimate, the audit, tax and agreed-upon procedures fees will be as detailed in Exhibit B. The fee estimate is based on anticipated cooperation from your personnel and the assumption that unexpected circumstances will not be encountered during the engagements. If significant additional time is necessary, we will discuss it with you and arrive at a new fee estimate before we incur the additional costs.

Government Auditing Standards require that we provide you with a copy of our most recent external peer review report and letter of comments, and any subsequent peer review reports and letters of comment received during the period of the contract. Our peer review report and letter of comments accompanies this letter.

We appreciate the privilege and opportunity to work with you and your staff during the completion of these important engagements. If the engagement letter terms are acceptable and in accordance with your understanding of each engagement, please sign the attached agreement and return the signed agreement page. Please retain the original letter and the client copy of the agreement page for your files. If you have any questions or comments regarding the terms of this engagement letter, please do not hesitate to contact us.

Very truly yours,

CPA FIRM NAME
Certified Public Accountants

EXHIBIT A

Schedule of Agreed-Upon Procedures:

1.) Examine selected receipts, invoices, cancelled checks, (or check imaging on original bank statement) etc. that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project.
2.) Confirm the balance in the replacement reserve account presented on Form RD 3560-7, Part III and confirm that no amounts were encumbered by the financial institution that holds the accounts. Determine that all balances are within the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC) insurance limits, as applicable. Determine that the total withdrawals from the bank statements agree to the total withdrawals authorized by Rural Development on Form RD 3560-12. Compare the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals.
3.) Obtain an Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determine that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project.

EXHIBIT B

Entity and Fee Schedule
Year End DATE, YEAR

ENTITY NAME	FEE AMOUNT

CPA FIRM NAME SERVICE AGREEMENT

Agreement to report on Rural Development Financial and Compliance Reports and prepare Federal, State & Local tax reporting forms for the Entities listed in the attached Exhibit B managed by Company Name as outlined in the CPA FIRM NAME engagement letter dated Date, Year.

To accept the schedule of fees in Exhibit B and the terms as stated in the attached engagement letter:

- Sign below,
- Return this page to us,
- Retain the original engagement letter and the client copy of this letter for your files.

By: ______________________________________ Date:______________
(Signature)

____
(Name, Printed)

____
(Title)

Client Copy

CPA FIRM NAME SERVICE AGREEMENT

Agreement to report on Rural Development Financial and Compliance Reports and prepare Federal, State & Local tax reporting forms for the Entities listed in the attached Exhibit B managed by Company Name as outlined in the CPA FIRM NAME engagement letter dated Date, Year.

To accept the schedule of fees in Exhibit B and the terms as stated in the attached engagement letter:

- Sign below,
- Return this page to us,
- Retain the original engagement letter and the client copy of this letter for your files.

By: _______________________________________ Date:______________
(Signature)

____
(Name, Printed)

____
(Title)

EXHIBIT A
Schedule of Agreed-Upon Procedures:

1.) Examine selected receipts, invoices, cancelled checks, (or check imaging on original bank statement) etc. that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project.
2.) Confirm the balance in the replacement reserve account presented on Form RD 3560-7, Part III and confirm that no amounts were encumbered by the financial institution that holds the accounts. Determine that all balances are within the Federal Deposit Insurance Corporation (FDIC) or the Securities Investor Protection Corporation (SIPC) insurance limits, as applicable. Determine that the total withdrawals from the bank statements agree to the total withdrawals authorized by Rural Development on Form RD 3560-12. Compare the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals.
3.) Obtain an Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determine that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project.

EXHIBIT B

Entity and Fee Schedule
Year End DATE, YEAR

ENTITY NAME	FEE AMOUNT

Attachment 4-H
Example Combined Audit & AUP
(Projects with 24 Units or more)

1.1.1. ANY TOWN LIMITED PARTNERSHIP

FINANCIAL AND COMPLIANCE REPORTS
DATE YEAR and YEAR

CONTENTS

Independent Auditors' Report

To the Partners of
Any Town Limited Partnership
DBA Any Town Apartments
City, State

USDA Rural Development
Servicing Office
City, State

We have audited the accompanying balance sheets of Any Town Limited Partnership (a limited partnership), DBA Any Town Apartments, Case No. 00-000-000000000, as of DATE YEAR and YEAR, and the related statements of operations, changes in partners' equity (deficit) and cash flows for the years then ended. 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 audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, the 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Any Town Limited Partnership, at DATE YEAR and YEAR, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated DATE, 200X, on our consideration of Any Town Limited Partnership's internal control over financial reporting and 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 read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying supplementary information shown on page 17 is presented for purposes of additional analysis and is not a required part of the basic financial statements of the Partnership. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

CPA FIRM NAME

Certified Public Accountants

DATE, 200X

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
BALANCE SHEETS
DATE YEAR and YEAR

ASSETS

Current Assets	200X	200X
Cash	$ 0	$ 0
Accounts Receivable - Subsidy	-	-
Accounts Receivable - Tenants	-	-
Prepaid Expenses	-	-
	-	-
Restricted Cash and Funded Reserves		
Tenant Security Deposits	-	-
Reserve for Taxes & Insurance	-	-
Reserve for Replacement	-	-
	-	-
Rental Property		
Land	-	-
Buildings & Improvements	0	-
Furnishings & Equipment	-	-
	-	-
Less: Accumulated Depreciation	-	-
	-	-
Other Assets		
Capitalized Costs - Net	-	-
Total Assets	$ 0	$ 0

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
BALANCE SHEETS - Continued
DATE YEAR and YEAR

LIABILITIES AND PARTNERS' EQUITY (DEFICIT)

Current Liabilities	**200X**	**200X**
Accounts Payable - Trade	$ -	$ -
Accrued Mortgage Interest	-	-
Accrued Real Estate Taxes	-	-
Current Portion of Mortgage Payable	-	-
	-	-
Deposit and Prepayment Liabilities		
Tenant Security Deposits	-	-
Prepaid Rents	-	-
	-	-
Long Term Liabilities		
Due to Partners	-	-
Mortgage Payable - Net of Current Portion	-	-
	-	-
Total Liabilities	-	-
Partners' Equity (Deficit)		
End of Period	-	-
Total Liabilities and Partners' Equity (Deficit)	$ -	$ -

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
STATEMENTS OF OPERATIONS
DATE YEAR and YEAR

	200X	200X
Rental Income		
Apartments	$ -	$ -
Less: Overage		
Tenant Utility Allowance		
Tenant Assistance Payments	-	-
Potential Rental Income	-	-
Less: Vacancies	-	-
Total Rental Income	-	-
Other Income		
Application Fees		
Laundry & Vending		
Interest Income		
Tenant Charges		
Other Income	-	-
Total Other Income	-	-
Total Income	-	-
Expenses		
Operating & Maintenance Expenses	-	
Utilities Expenses	-	
Administrative Expenses	-	
Taxes & Insurance	-	
Bad Debts	-	
Interest on Mortgage Payable	-	-
Total Expenses	-	-
Income / (Loss) from Operations	-	-
Non-Operating (Income) & Expense		
Interest Subsidy Income	-	
Interest Subsidy Expense	-	-
Depreciation	-	
Amortization	-	
Partnership Fees	-	-
Total Non-Operating Income & Expense	-	-
Net Income / (Loss)	$ -	$ -

The accompanying notes are an integral part
of these financial statements.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
STATEMENTS OF CHANGES IN PARTNERS' EQUITY (DEFICIT)
Years ended DATE YEAR and YEAR

	General Partner	Limited Partner	Total
Partners' Equity (Deficit), January 1, 200X			$ -
Cash Distributions			-
Net Income / (Loss)			-
Partners' Equity (Deficit), December 31, 200X	-	-	-
Cash Distributions			-
Net Income / (Loss)			-
Partners' Equity (Deficit), December 31, 200X	$ -	$ -	$ -

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
STATEMENTS OF CASH FLOWS
Years ended DATE YEAR and YEAR

Operating Activities	**200X**	**200X**
Net Income / (Loss)	$ -	
Adjustments to Reconcile Net Income / (Loss) to Net Cash From Operating Activities		
Depreciation & Amortization	-	
Decrease (Increase) in Assets:		
Accounts Receivable	-	
Prepaid Expenses	-	
Security Deposits - Funded	-	
Increase (Decrease) in Liabilities:		
Accounts Payable		
Accrued Interest	-	
Accrued Real Estate Taxes	-	
Security Deposits - Liability	-	
Prepaid Rents	-	
Net Cash From Operating Activities	-	-
Investing Activities		
Reserve for Taxes & Insurance	-	
Reserve for Replacement	-	
Purchase / Disposal of Rental Property	-	
Net Cash From Investing Activities	-	-
Financing Activities		
Advances from Partners		
Distributions	-	
Mortgage Principal Payments	-	
Net Cash From Financing Activities	-	-
Net Increase / (Decrease) in Cash	-	-
Cash at Beginning of Period	-	
Cash at End of Period	$ -	$ -
Supplemental Disclosures		
Interest Paid	$ -	$ -
Interest Subsidy	$ -	$ -

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS
Years ended DATE YEAR and YEAR

A. Organization

Any Town Limited Partnership ("the Partnership") was formed in **Month Year**, under the laws of the State of **STATE**, for the purpose of constructing and operating a **00**-unit apartment community ("Any Town Apartments") located in **CITY, STATE**. The community is financed by a USDA Rural Development **Section 515 Loan**, and therefore is regulated by Rural Development as to rent charges and operating methods. The apartment community began operations in **Month Year**.

The management of the Partnership and the ongoing management of Any Town Apartments are vested in the Partners. The Partnership has hired **MANAGEMENT COMPANY** an affiliate of one of the partners, to provide day to day management for the property. Compensation for such services is as determined under the partnership and management agreements.

B. Significant Accounting Policies

A summary of the Partnership's significant accounting policies consistently applied in the preparation of the accompanying financial statements are as follows:

Basis of Accounting

The Partnership utilized the accrual basis of accounting, whereby income is recognized as earned and expenses are recognized as obligations are incurred.

Cash and Cash Equivalents

Cash and cash equivalents consist of short-term investments with an original maturity of three months or less, cash on deposit, money market funds and certificates of deposit.

Tenant Receivable and Bad Debt Policy

Tenant rent charges for the current month are due on the first of the month. Tenants who are evicted or move-out are charged with damages or cleaning fees, if applicable. Tenant receivable consists of amounts due for rental income, security deposit or the charges for damages and cleaning fees. The Partnership does not accrue interest on the tenant receivable balances.

The Partnership has not established an allowance for doubtful accounts and does not use the reserve method for recognizing bad debts. Bad debts are treated as direct write-offs in the period management determines that collection is not probable. Included in expenses are bad debts of $XXX and $XXX for the years ending DATE YEAR and YEAR, respectively.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

B. Significant Accounting Policies – (Continued)

Rental Property

Rental property is recorded at cost. Improvements are capitalized, while expenditures for maintenance and repairs are expensed as incurred. Upon disposal of depreciable property, the appropriate property accounts are reduced by the related costs and accumulated depreciation. The resulting gains and losses are reflected in the statements of operations. The rental property is depreciated over estimated service lives as follows:

Buildings & Improvements	40	years	straight-line
Land Improvements	20	years	straight-line
Furnishings & Equipment	7	years	straight-line

The Partnership reviews its investment in real estate for impairment whenever events or changes in circumstances indicate that the carrying value of such property may not be recoverable. Recoverability is measured by a comparison of the carrying amount of the real estate to the future net undiscounted cash flow expected to be generated by the rental property including the low income housing tax credits and any estimated proceeds from the eventual disposition of the real estate. If the real estate is considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of the real estate exceeds the fair value of such property. There were no impairment losses recognized in YEAR or YEAR.

Partners' Equity

Profit and loss is to be allocated to GENERAL PARTNER (1%) (General Partner) and LIMITED PARTNER (99%) (Limited Partner) other than special allocations (as defined by the Partnership Agreement) and certain other items which would be specifically allocated to the partners in accordance with the Partnership Agreement.

Income Taxes

No provision or benefit for income taxes has been included in these financial statements since taxable income passes through to, and is reportable by, the partners individually.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

B. Significant Accounting Policies – (Continued)

Return to Owner

In accordance with the Loan Agreement(s), the maximum annual cash return to owner allowable by Rural Development for the Partnership is $XXX or X% of the required equity investment of $XXX and is allocated to the partners as formulated in the Partnership Agreement.

C. Mortgage Payable

Original Mortgage

The mortgage note is payable to Rural Development in monthly installments of $XXX, at an interest rate of X% and a term of XX years, maturing in the year 20XX. As part of the Loan Agreement, the Partnership entered into an Interest Credit and Rental Assistance Agreement that reduces the monthly mortgage payment to $XXX, which effectively lowers the interest rate to approximately 1% over the term of the loan. The mortgage liability of the Partnership is limited to the underlying value of the real estate collateral pledged.

Rehabilitation Mortgage

The mortgage note is payable to Rural Development in monthly installments of $XXX, at an interest rate of X% and a term of XX years, maturing in the year 20XX. As part of the Loan Agreement, the Partnership entered into an Interest Credit and Rental Assistance Agreement that reduces the monthly mortgage payment to $XXX, which effectively lowers the interest rate to approximately 1% over the term of the loan. The mortgage liability of the Partnership is limited to the underlying value of the real estate collateral pledged.

Maturities of the mortgage notes in each of the next five years are approximated as follows:

200X	$	-
200X	$	-
200X	$	-
200X	$	-
200X	$	-

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

C. Mortgage Payable – (Continued)

Under the Loan Agreement(s) with Rural Development, the Partnership is required to make monthly deposits into the reserve for replacement account, and is subject to operating and return to owner restrictions.

There has been no significant change in interest rates available to the Partnership. Therefore, the fair value of the mortgage notes approximate the book value.

D. Related Party Transactions

Management Fee

The Partnership has entered into a management agreement with MANAGEMENT AGENCY, INC., an affiliate of the General Partner, to manage the rental operations of the apartment community. Property management fees expensed were $XXX and $XXX in 200X and 200X, respectively. The amount due to the management agent related to management fees as of DATE YEAR and YEAR totaled $XXX and $XXX, respectively.

Management Services

The management agent provides administrative services to the Partnership. The management agent was reimbursed $XXX and $XXX for the cost of site employee payroll and benefits during 200X and 200X, respectively.

Investor Asset Management Fee ***(if Applicable*****)**

The Partnership shall pay to the Investment Limited Partner an annual asset management fee in the amount of $XXX for its services in assisting in monitoring Partnership activities. The asset management fee is payable solely from the annual return to owner. To the extent that the Partnership cannot pay a return to owner, the fee shall accrue and be payable on a cumulative basis from future cash distributions. Accrued and unpaid fees totaled $XXX as of DATE YEAR and YEAR and are included in Due to Partners in the accompanying Balance Sheets.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
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NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

D. Related Party Transactions – (Continued)

*Partnership Management Fee **(if Applicable)***

The Partnership shall pay to the General Partner an annual partnership management fee in the amount of $XXX. The partnership management fee shall be payable solely from the annual return to owner and is non-cumulative. Partnership management fees expensed were $XXX and $XXX in 200X and 200X, respectively.

*Development Fee **(if Applicable)***

The development agreement provides that a development fee of $XXX be paid to the Developer, an affiliate of the General Partner, for providing certain development services and guarantees for the completion of the development of the apartment community. The total development fee was capitalized as a depreciable cost of rental property. As of DATE YEAR and YEAR, the amount of development fee deferred for future payment totaled $XXX and $XXX, respectively. Payment of the fee will occur as set forth in the Partnership Agreement.

E. Commitments and Contingencies

Interest Credit and Rental Assistance Agreement

Under an agreement with Rural Development, mortgage subsidy is provided which reduces the effective interest rate on the mortgage to approximately 1% over the life of the Loan Agreement. Rural Development may terminate the agreement if it determines that no subsidy is necessary or if the Partnership is determined to be in violation of the Loan Agreement(s) or Rural Development rules or regulations.

Rental Assistance Agreement

The Partnership has entered into a Rental Assistance Agreement with Rural Development commencing DATE, YEAR, providing rental assistance for XX units. The agreement provides for a maximum rental assistance commitment of $XXX. The agreement expires automatically upon total disbursement of this amount, but is then renewable under contract with Rural Development pending congressional approval of budget authority.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
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NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

E. Commitments and Contingencies – (Continued)

Housing Tax Credits (Unaudited) **(if Applicable)**

As incentive for investment equity, the Partnership applied for and received an allocation certificate for housing tax credits established by the Tax Reform Act of 1986. To qualify for the tax credits, the Partnership must meet certain requirements, including attaining a qualified basis sufficient to support the credit allocation. In addition, tenant eligibility and rental charges are restricted in accordance with Internal Revenue Code Section 42. Management has certified that each tax credit unit has met these qualifications to allow the credits allocated to each unit to be claimed.

Compliance with these regulations must be maintained in each of the fifteen consecutive years of the compliance period. Failure to maintain compliance with occupant eligibility, unit gross rent, or to correct noncompliance within a reasonable time period could result in recapture of previously claimed tax credits plus interest.

The expected availability of the remaining tax credits is as follows:

200X	$ -
200X	-
200X	-
200X	-
200X	-
200X	-
200X	-
	$ -

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

E. Commitments and Contingencies – (Continued)

Restrictive Covenant **(if Applicable)**

The Partnership is bound by a restrictive covenant. The covenant states that XX% of the project property must be maintained as low-income housing for an initial compliance period of 15 years, and for the extended use period of an additional 15 years, unless terminated after the end of the initial 15-year period.

In addition, the covenant requires rent restrictions so that the units can be rented at a level that is affordable to persons with income at or below specific percentages of the area median gross income ("AMGI"). These restrictions are as follows:

Income Restrictions

XX units with household income at or below XX% of the AMGI
XX units with household income at or below XX% of the AMGI

Rent Restrictions
XX units with rents at XX% of the AMGI

F. Current Vulnerability Due to Certain Concentrations

The Partnership's sole asset is Any Town Apartments. The Partnership's operations are concentrated in the affordable housing real estate market. In addition, the Partnership operates in a heavily regulated environment. The operations of the Partnership are subject to the administrative directives, rules and regulations of federal, state and local regulatory agencies, including, but not limited to, Rural Development and the State Housing Agency. Such administrative directives, rules and regulations are subject to change by an act of Congress or an administrative change mandated by Rural Development or the State Housing Agency. Such changes may occur with little notice or inadequate funding to pay for the related cost, including the additional administrative burden, to comply with a change.

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS - Continued
Years ended DATE YEAR and YEAR

G. Concentration of Credit Risk (if Applicable)

The Partnership maintains its cash in financial institutions insured by Federal Deposit Insurance Corporation (FDIC). Deposit accounts, at times, may exceed federally insured limits. The Partnership has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

H. Reconciliation of Taxable Net Loss (Optional)

The Partnership's financial statements and tax returns are prepared on the accrual basis. A reconciliation of the financial statement net income/(loss) to the tax return ordinary income/(loss) of the Partnership, as reported on the Partnership's information return, for the years ended DATE YEAR and YEAR is as follows:

	200X	200X
Financial Statement Net Income / (Loss)	$ -	$ -
Reconciling Items:		
Book / Tax Difference for Depreciation	-	-
Book / Tax Difference for Amortization	-	-
Prepaid Rents Difference	-	-
Partnership Tax Return Ordinary Income / (Loss)	$ -	$ -

SUPPLEMENTAL INFORMATION

1. Management Fee Calculation

The management fee is based on a fee per unit occupied by tenants during the month.

Total Qualified Units (XX * 12 months)	-
Less: Rent Free Unit	
Vacancies	
Total Occupied Units	-
Fee Per Unit (Effective MONTH, YEAR)	$ -
Management Fee Expense	$ -

2. Insurance Disclosure

The Partnership maintains Insurance coverage as follows:

	Deductible	Coverage
Property Coverage on Buildings	$XXX	$XXX
Comprehensive Business Liability	$XXX	$XXX
Fidelity / Employee Dishonesty	$XXX	$XXX

3. Return to Owner

In accordance with the Loan Agreement, the annual return to owner is as follows:

Maximum Return to Owner (See Note B)	-
Budgeted Return to Owner	-
Return to Owner Paid:	
Investor Asset Management Fee	
Partnership Management Fee	
General Partner Distribution	-
Limited Partner Distribution	-
	$ -

The accompanying notes are an integral part
of these financial statements.

Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Partners of
Any Town Limited Partnership
DBA Any Town Apartments
City, State

USDA Rural Development
Servicing Office
City, State

We have audited the financial statements of Any Town Limited Partnership as of and for the year ended DATE, YEAR, and have issued our report thereon dated DATE, 200X. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered Any Town Limited Partnership's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. According, we do not express an opinion on the effectiveness of the Partnership's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Partnership's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Partnership's financial statements that is more than inconsequential will not be prevented or detected by the Partnership's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Partnership's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Any Town Limited Partnership's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended for the information of the partners, management and the U.S. Department of Agriculture Rural Development and is not intended to be and should not be used by anyone other than these specified parties.

CPA FIRM NAME

Certified Public Accountants

DATE, 200X

Reportable Conditions of Non Compliance

DATE, YEAR – None Noted

Note to CPA / Borrower: *Follow YellowBook guidelines when reporting findings. This should include the statement of conditions, criteria, effect, cause and recommendations.*

Auditee's Comments on Prior Audit Resolution Matters Related to United States Department of Agriculture Rural Development Programs.

There were no significant unresolved findings from previous annual audits, physical inspections or management review reports during our audit of the 200X financial statements. There were no compliance findings noted during our audit of the 200X financial statements relating to physical inspections or management reviews for which the Partnership has not taken corrective action.

Independent Accountants' Report on Applying Agreed-Upon Procedures

To the Partners of
Anytown Apartments Limited Partnership
DBA Anytown Apartments
City, State

and

United States Department of Agriculture
Rural Development
Servicing Office
City, State

We have performed the procedures enumerated below, which were agreed to by the United States Department of Agriculture Rural Development and Anytown Apartments Limited Partnership ("Owner") the owner of Anytown Apartments ("Project") located in City, State, solely to assist those parties in evaluating that the accompanying Form RD 3560-10, Multiple Family Housing Borrower Balance Sheet, Form RD 3560-7, Multiple Family Housing Project Budget ("Financial Reports") and Supporting Documentation are prepared in accordance with the criteria specified in Rural Development Regulations contained in 7 CFR 3560 section 303(b) and section 306, in accordance with the determinations noted in Attachment 4-D of RD Handbook HB-2-3560, for the year ended DATE, YEAR. The owner is responsible for the presentation of the financial reports. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The sufficiency of these procedures is solely the responsibility of Rural Development and the owner. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. We examined selected receipts, invoices, and cancelled checks (or check imaging on original bank statement) that support administrative; and operating and maintenance expenses presented on Form RD 3560-7, Part II, line items 1-10 and 19-32 to determine they were incurred as part of the ongoing operations of the project. We selected a representative sample of invoices and supporting documentation, based on the sample size determined by Rural Development in Attached 4-D of RD Handbook HB-2-3560, for expenses included in Lines 1-10 and 19-32 of Form RD 3560-7 and determined that the services were eligible expenses, in accordance with Attachment 4-A of HB-2-3560, and the shipping address agreed to the project address. In addition, we confirmed a sample of the expenditures with the vendors to determine the invoice paid agreed to the vendor's records.

Findings:

Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:
Total Number of Invoices in Vendor Confirmation Sample:
Total Dollar Amount of Invoices in Vendor Confirmation Sample:
Total Number of Vendor Confirmations Not Received:
Total Dollar Amount of Vendor Confirmations Not Received:
Total Number of Deviations:
Total Dollar Amount of Deviations:

Note: *The CPA should provide enough detail for any deviations, that the user of the report would understand why the deviation is present.*

2. We confirmed the balance in the replacement reserve account presented on Form RD 3560-7, Part III, and confirmed that no amounts were encumbered by the financial institution that holds the accounts. We determined that all balances are within the FDIC insurance limits. We determined number of reserve account withdrawals from the original bank statements and compared the withdrawals to the amounts approved by Rural Development on Form RD 3560-12. We compared the invoices and cancelled checks (or check imaging on original bank statement) to the approved withdrawals from Rural Development.

Findings:

Total Number of Reserve Account Withdrawals:
Total Number of Withdrawals Authorized by Rural Development:
Total Dollar Amount of Reserve Account Withdrawals:
Total Dollar Amount of Withdrawals Authorized by Rural Development:
Total Number of Deviations:
Total Dollar Amount of Deviations:

The confirmation received from the financial institution agreed to the project's bank reconciliation and no encumbrances were noted on the confirmation. All withdrawals were paid to the vendors approved by Rural Development on Form RD 3560-12.

3. We obtained the Identity of Interest (IOI) company listing and Form RD 3560-31 from Rural Development and determined that the services provided and approved fees, if applicable, agree to the actual service and fees charged to the project. We examined a sample of invoices and determined that the services and charges are in accordance with the disclosures contained in Form RD 3560-31 as agreed to by Rural Development.

Findings:

Total Number of Forms RD 3560-31 Received:

Company Name 1:
Total Dollar Amount for the Year:
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Company Name 2:
Total Dollar Amount for the Year:
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

The agree-upon procedures performed above and the management Representation Letter revealed no undisclosed IOI companies.

Note: *If an IOI Company performs more than one service for the project, the CPA should identify each service and fees associated with that service separately. Rural Development wants information that they can tie back to the 3560-7 and their internal IOI tracking procedures. For example:*

ABC Management Co.

Management Fees
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Bookkeeping Fees
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

Payroll / Employee Benefits Reimbursement
Total Number of Invoices in Population:
Total Dollar Amount of Invoices in Population:
Total Number of Invoices Reviewed:
Total Dollar Amount of Invoices Reviewed:

The accompanying notes are an integral part
of these financial statements

We were not engaged to, and did not, conduct an audit of the subject matter, the objective of which would be the expression of an opinion on the agreed-upon procedures applied to the financial reports and supporting documentation of Anytown Apartments. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the owner and management agent of Anytown Apartments, and Rural Development, and is not intended to be and should not be used by anyone other than these specified parties.

CPA FIRM NAME

Certified Public Accountants

DATE, 2008

SUPPORTING DOCUMENTATION

INCLUDE FORMS RD 3560-7 AND 3560-10

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
SUPPORTING DOCUMENTATION TO FORMS RD 3560-10 AND 3560-7
Years ended DATE YEAR and YEAR

1. Accounts Receivable (3560-10, Line 7)

Accounts Receivable - Rental Subsidy	$ -	
Accounts Receivable - Tenants	-	
Accounts Receivable - Other	-	$ -

2. Notes Payable (3560-10, Line 23)

Accrued Mortgage Interest	$ -	
Accrued Real Estate Taxes	-	
Prepaid Rents	-	$ -

3. Other (3560-10, Line 27)

Due to Partners		$ -

4. Miscellaneous (3560-7, Line 27)

Bad Debts	$ -	
Other	-	$ -

ANY TOWN LIMITED PARTNERSHIP
DBA Any Town Apartments
Case No. 00-000-0000000000
NOTES TO THE FINANCIAL STATEMENTS
Years ended DATE YEAR and YEAR

5. Accrual to Cash Adjustment (3560-7, Line 32)

Assets		
Accounts Receivable	$ -	
Prepaid Expenses	-	
Security Deposits	-	
Liabilities		
Accounts Payable - Trade	-	
Accrued Real Estate Taxes	-	
Security Deposits & Prepaid Rents	-	
Other Adjustments		
2008 Mortgage Payment made in 2007	-	$ -

The accompanying notes are an integral part
of these financial statements.