

a regulatory and lease citation that could be used in bringing court proceeding against an abusive borrower/owner. Further, it would provide RHS with an additional instance of non-compliance with regulations that could be used against the owner in a liquidation action or criminal or civil court case. However, it is uncertain whether cases could be resolved more quickly at less cost to the Government.

While the proposed rule offers some additional protection to tenants and imposes some additional responsibility on borrower/owners, it is difficult to place a monetary value on these impacts. Each case is likely to be different, and the resolutions uncertain. The low incidence, however, suggests that the impacts would not be significant in value.

Application Process for Rental Subsidies

Rental subsidies provide critical funds for housing very low-income tenants. Projects that receive RHS' rental assistance, including interest subsidy and rental assistance payments, depend on the continued availability of these subsidies to maintain in-place tenants in their units.

Under the current regulations, borrowers must complete full rental assistance requests to renew expiring subsidies. Stakeholders noted that the agency gathers sufficient information through the budget approval process to assess project needs for rental assistance.

Therefore, the proposed rule states that expiring subsidies will be renewed, at the existing number of units; to the extent sufficient funds are available. To indicate that rental assistance units are needed, the borrower must fill in a single check box on the project budget form (which must be filed annually) instead of completing a separate form as currently required. These changes relieve borrowers of the burden of applying and the agency the burden of reviewing the requests. The review can instead be accomplished as part of the budget approval process. The change has no effect on project or program budgets, as it does not change the agency determination about rental subsidies, it simply streamlines the process.

Budget Approval

RHS requires its borrowers to submit an annual budget, which is used in setting rents. Approximately 92 percent of these budgets arrive for approval at the same time because most owners operate on a calendar year basis and their schedules for developing budgets

is about the same. Budget approval is a time-consuming process that taxes RHS staff resources in times of high volume and forces borrowers to operate for extended periods of time with unapproved budgets while the review process is underway. Current regulations require that all budgets be reviewed in the same way, regardless of whether they represent no real change from the previous year or contain significant and potentially controversial changes. The proposed rule establishes an expedited review for those budgets that are within a certain threshold requiring little or no increase in rents. The threshold will be based on data to be obtained from the MFIS III ADP system on area-wide norms for projects within RHS' MFH portfolio as well as commercially-available family income and expense surveys. Details on how the threshold will be computed will be contained in a handbook rather than the proposed rule. This will facilitate making any necessary adjustments in the threshold to meet changing conditions.

The new process could improve program performance by allowing RHS to focus its review on those budgets that contain significant changes while expediting approval of those with little or no change. However, it is unlikely that the new process would have measurable budget impacts, such as reduced rental assistance costs or fewer defaults, because the decisions RHS makes on whether or not to approve a budget will most likely be the same under the new process as under the existing system. Those decisions will, however, be reached in a more efficient manner.

Annual Financial Reporting

Under the current regulations, the agency requires that for all projects of 25 units or more, the owner contract with a CPA perform an audit in accordance with generally accepted government auditing standards (GAGAS). Because a large percentage of the Agency's portfolio consists of projects with between 16 and 24 units, audited financial statements have not been prepared for a substantial number of projects financed by the Agency. In addition, the current audit guide currently does not require the auditor to provide information that is of specific importance to the agency, such as information on Identity-of-Interest transactions.

Under the proposed regulation, large MFH projects, defined as projects with 16 or more units, will be required to submit a GAGAS audit prepared by an independent CPA. The audit guide,

which is currently being revised, will provide specific instructions on how the auditor should handle compliance issues. The audit must be completed using "agreed upon procedures" that help meet certain performance standards. It must be initiated by the borrower using an engagement letter, which will either:

- Reference the Audit guide, which will specify the program compliance issues that the Agency wants the CPA to address, and guidelines for testing compliance; or
- State the list of compliance issues that the Agency wants the CPA to address.

Small projects, defined as projects with fewer than 16 units, must submit annual financial statements that are prepared in a manner consistent with the agency's audit guide and that is accompanied by a certification signed by the borrower. The annual financial statements may be prepared by a CPA or other individual with the training and experience to prepare the report. The information presented in the annual financial statements must be prepared in a manner consistent with the requirements of the audit guide.

In response to OIG concerns, the agency is proposing to implement these changes to the annual financial reporting system to ensure that a higher percentage of projects are prepared by CPAs, that GAGAS principles are followed in the preparation of these audits, and that the auditors are made aware of specific concerns of the agency, to ensure that project funds are spent appropriately.

Special Servicing, Enforcement, Liquidation, and Other Actions

In response to stakeholder, OIG and agency staff comments, the agency made a number of changes to strengthen agency servicing. None of the changes to the regulation on servicing constitute changes in policy; rather they address a lack of clarity in existing rules and incorporate policies that previously existed only in administrative notices. As such, the changes are not anticipated to have either a negative or positive budget impact.

For example, the proposed rule clarifies the definition of "default" by spelling out specific actions that an owner may take or fail to take that would cause the agency to determine that the loan is at risk. The proposed rule also simplifies the submission requirements for transfers of project ownership. Other changes serve to simplify servicing actions in an effort to enhance the agency's flexibility to address servicing issues.