## Table of Contents

**Introduction and welcome** .................................................................................................................. 5

1. Purpose ............................................................................................................................................... 5
2. Recommendations ............................................................................................................................... 5
3. What’s included in this manual ............................................................................................................. 5
4. What’s not included in this manual ....................................................................................................... 5
5. Where to ask questions .......................................................................................................................... 5

   Acronyms, abbreviations and glossary .................................................................................................. 5

1. Habitat for Humanity International financial policies .............................................................. 9
   1. Generally accepted accounting principles ..................................................................................... 9
   2. Fiscal year-end .................................................................................................................................. 9
   3. Financial policies overview .............................................................................................................. 9
      All affiliates .......................................................................................................................................... 9
      Affiliates over $25,000 in revenue or $250,000 in assets ................................................................. 10
      Affiliates over $250,000 in revenue or $500,000 in assets .............................................................. 11

4. Reporting to HFHI ............................................................................................................................. 11
   Mail to: ................................................................................................................................................. 11
   E-mail to: .............................................................................................................................................. 11
   Fax to: ..................................................................................................................................................... 11

5. Accrual basis of accounting ............................................................................................................... 12

6. Contributions – accrued or deferred ................................................................................................. 13

7. Contributions – conditional promises to give .................................................................................... 13

8. Contributions – restrictions ............................................................................................................... 14
   Designated funds ...................................................................................................................................... 14
   Fund for Humanity ............................................................................................................................... 14

9. Contributions – services ..................................................................................................................... 15

10. Contributions – materials and property ............................................................................................ 15

11. Other income .................................................................................................................................... 16
   Special events ........................................................................................................................................ 16
   Habitat for Humanity ReStore/Thrift stores ....................................................................................... 17

12. Sale of houses and mortgages to homeowners .............................................................................. 17
   Down payment assistance grants ......................................................................................................... 18
   Construction in process and house costs .............................................................................................. 18
   First mortgages ..................................................................................................................................... 18
   Second mortgages ............................................................................................................................... 18
   Renting houses ...................................................................................................................................... 19

13. Mortgage discounting ....................................................................................................................... 19

14. Notes Payable .................................................................................................................................... 20

15. Escrow accounts .............................................................................................................................. 20

16. Mortgage delinquencies .................................................................................................................... 21
17. Foreclosure/deed in lieu ................................................................. 21
18. Cost of tithing .............................................................................. 22
19. Fixed assets and depreciation ...................................................... 22
20. Categories of expense ................................................................. 22
    Program Services ........................................................................ 22
    Management and General (Administrative) .................................. 23
    Fundraising ................................................................................. 23
    Allocating and distributing expenses ........................................... 23
21. Independent audits and compilations .......................................... 24
22. IRS and state or local reports ....................................................... 24
23. Financial record keeping ............................................................ 25
    Fiscal safeguards and internal controls ....................................... 26
1. Fiscal safeguards ........................................................................ 26
2. General financial controls .......................................................... 26
    Basics of financial control ......................................................... 26
3. Organization, functions and duties ................................................ 27
4. Officers ......................................................................................... 27
5. Finance committee ..................................................................... 27
6. Staff ............................................................................................. 28
7. Separation of duties .................................................................. 28
8. Conflict of interest ..................................................................... 28
9. Cash and related accounts .......................................................... 29
    Cash .......................................................................................... 29
    Bank accounts .......................................................................... 30
    Excess cash ............................................................................. 30
10. Purchasing process .................................................................... 30
    Purchase orders ....................................................................... 30
    Subcontracts .......................................................................... 30
    Vendors ................................................................................. 31
11. Mortgages ................................................................................. 31
12. Other asset controls .................................................................. 31
13. Monthly reports and audits ........................................................ 31
14. Staff safeguards ....................................................................... 32
    Plans and budgets ................................................................. 33
1. Strategic plan ............................................................................. 33
2. Annual operating budget ........................................................... 33
3. Support and revenue projections ................................................. 34
    Projected Support and Revenues ............................................. 34
4. Expense projections ................................................................. 35
    Projected Expenses ............................................................... 36
5. House pricing ........................................................................... 36
6. Job/house costs...................................................................................................................... 37
7. Growth .................................................................................................................................. 37
8. Cash flow budget .................................................................................................................. 37
   Cash Flow Projections............................................................................................................. 38
9. Managing cash flow .............................................................................................................. 39
10. Borrowing ............................................................................................................................ 39
11. Loan programs ..................................................................................................................... 39
4. Chart of accounts................................................................................................................... 40
   1. Introduction to the chart of accounts.................................................................................. 40
      Tracking job/house costs...................................................................................................... 41
      House address...................................................................................................................... 41
      Items....................................................................................................................................... 41
      Class or category.................................................................................................................... 41
   2. Sample accounting entries................................................................................................. 41
   3. Other accounting software ............................................................................................... 41
5. Reporting.................................................................................................................................. 42
   1. Financial reporting............................................................................................................... 42
   2. External reporting............................................................................................................... 42
   3. Internal reporting............................................................................................................... 42
   4. Monthly reporting.............................................................................................................. 42
   5. Required financial statements........................................................................................... 42
   6. Accounting systems........................................................................................................... 43
   7. Accounting calendar.......................................................................................................... 44
   8. Tax reporting and payments.............................................................................................. 44
   9. IRS 990 ............................................................................................................................... 46
  10. Independent audits............................................................................................................... 46
6. Where to ask questions and find resources........................................................................... 48
   1. My.Habitat ......................................................................................................................... 48
   2. E-mail and telephone support............................................................................................ 48
Appendix 1: RESPA memo ....................................................................................................... 49
Introduction and welcome

1. Purpose
The Affiliate Operations Manual: Financial Policies and Procedures provides guidance in financial and accounting matters typically encountered by affiliates in the United States. U.S. affiliates must comply with appropriate policies of Habitat for Humanity International to ensure financial accountability throughout the Habitat ministry. An overview of the policies in this manual is included at the beginning of Chapter 1, and additional detail is provided throughout the manual.

2. Recommendations
Habitat for Humanity International requires that affiliates use automated accounting systems. HFHI recommends QuickBooks Pro or Premier accounting software because it can provide valuable job/house costing information. The Pro or Premier versions are recommended because of their advanced job costing and integration with Outlook, Word and Excel. Samples tailored to QBP are available on My.Habitat.org. Also, QuickBooks Premiere can effectively be used for the purpose of funding accounting.

Other accounting software packages may also be acceptable. Good accounting software will provide the tools needed for writing checks, payroll, budgeting and financial reporting. HFHI provides a chart of accounts template for QBP 2006 (or newer versions) that can also be adapted for use with other accounting software.

All affiliates would benefit greatly from using the recommended software. New affiliates should start with the recommended software at the outset of business.

3. What’s included in this manual
In addition to an overview of Habitat for Humanity International financial policies, this manual includes information on internal controls, planning and budgeting, reporting and more. This information will help new affiliates as well as growing affiliates. My.Habitat contains many supplementary resources, including interim and annual reports.

http://my2.habitat.org/kc/operations-governance/reporting

4. What’s not included in this manual
This manual assumes that the reader understands basic accounting principles. It does not provide assistance for using QBP or other accounting software. Most community colleges offer classes in basic accounting and the use of accounting software.

5. Where to ask questions
The best place to find information is on My.Habitat. This website was developed for Habitat affiliates to find and share all types of valuable information. The Internet address is:

http://my2.habitat.org/kc

For assistance with affiliate accounting matters or QuickBooks, send an e-mail to accountinghelp@habitat.org or call 800-HABITAT, ext.7959.

Acronyms, abbreviations and glossary
These frequently used acronyms and other abbreviations will serve as a useful reference as you read through the manual.

AAR: Accelerated Asset Recovery was the name used for HFHI’s original mortgage leveraging program, pursuant to which HFHI extended loans to affiliates secured by specific loans in the affiliates’ portfolios. The AAR program has been replaced by the Flexible Capital Asset Program. Many affiliates and HFHI staff use the phrase
“accelerated asset recovery” to refer generically to the use of a portion of the current mortgage portfolio to obtain funds to build more houses, either through sales of the mortgages or as collateral for loans. This is not an industry standard use of the phrase, however, and would not necessarily have a recognized meaning outside of the Habitat community.

AICPA: American Institute of Certified Public Accountants, the national professional association for certified public accountants in the United States. [www.aicpa.org](http://www.aicpa.org)

APB: Accounting Principles Board. The APB was the former authoritative body of the American Institute of Certified Public Accountants and issued pronouncements on accounting principles until 1973, when it was replaced by the Financial Accounting Standards Board.

AOM: Affiliate Operations Manual is the name Habitat for Humanity International uses for manuals covering basic affiliate operations.

ARMA: This nonprofit association of information management professionals offers training and education on standards and best practices. [www arma org](http://www arma org)

CB: Capacity Building. The development of an organization’s core skills to improve its ability to achieve the organizational mission. Capacity Building includes plans and activities to move the affiliate to the next level of building, such as from an all-volunteer affiliate to one with paid staff or increased house production.

CFF: Cash flow forecast. The plan for future cash in vs. cash out. This is used to show cash needs and to make decisions that may accelerate or delay some spending.

CIP: Construction in Process. The asset account used to record building costs from the beginning of the house until it is sold to the homeowner.

COA: Chart of accounts. The list of all accounts in the general ledger.

CPA: Certified public accountant. Accountants who are licensed by the individual state board of accountancy in the state(s) in which they practice.

EIN: Employer Identification Number issued by the IRS, also frequently referred to as a “Federal Tax Identification Number.” NOTE: The EIN is not the same as the Group Exemption Number, defined below, nor is it the same as the Tax Exempt Number for affiliates who have applied to the IRS for tax-exempt status. Each affiliate will have its own EIN separate from HFHI, whether or not it elects to operate under the Group Exemption Number.

FAS: Field Auditing Standards are the standards for auditing, published by the AICPA.

FASB: Financial Accounting Standards Board, a private, not-for-profit organization whose primary purpose is to develop generally accepted accounting principles within the United States in the public’s interest. The Security and Exchange Commission designated FASB as the organization responsible for setting accounting standards for public companies in the United States. It was created in 1973, replacing the Committee on Accounting Procedure and the Accounting Principles Board of the American Institute of Certified Public Accountants. [www fasb org](http://www fasb org)

FDIC: Federal Deposit Insurance Corp. is an independent agency of the federal government that insures deposits up to the specified legal level in banks and thrift institutions.
**FlexCAP**: Flexible Capital Asset Program is HFHI’s current mortgage leveraging program, pursuant to which affiliates can pledge specified mortgages to HFHI in return for a seven- or 10-year interest-bearing loan. FlexCAP replaced the prior AAR program.

**FMV**: Fair market value.

**GAAP**: Generally accepted accounting principles.

**GGAAP**: Governmental generally accepted accounting practices.

**GASB**: Governmental Accounting Standards Board.

**GEN**: Group Exemption Number. HFHI has obtained a group 501(c)(3) exemption. This four-digit number is used by the IRS to associate affiliates in good standing with HFHI’s group. The GEN does not apply to affiliates who have applied to the IRS and been individually approved as a 501(c)(3) nonprofit corporation. **NOTE**: The GEN is not the same as the EIN, defined above.

**GIK**: Gifts-in-kind are goods and services donated to charities instead of money. For more information, see the U.S. Gifts in Kind feature on My.Habitat. [http://gik.habitat.org/home](http://gik.habitat.org/home)

**HFHI**: Habitat for Humanity International serves affiliates and national offices of Habitat for Humanity.

**Liens**: A lien is a claim because of an unpaid debt that is filed against assets of the debtor. Typically, it might result from the unpaid debt of a homeowner, and when filed, it becomes a lien against the homeowner’s property. It also can result from the unpaid claim of an affiliate’s subcontractor or from the unpaid claim of a subcontractor or vendor that has done work for a subcontractor or vendor of the affiliate. In the latter situation, it can happen even if the affiliate has paid its subcontractor or vendor. Lien laws and the procedures for dealing with them or “waiving lien rights” are very state-specific.

**OMB**: Office of Management and Budget. OMB manages and directs federal government budgets for the President of the United States and provides additional accounting requirements for affiliates using government funds. [www.omb.gov](http://www.omb.gov)

**PO**: Purchase orders are purchase contracts between an organization and an entity that is providing goods or services.

**QBP**: QuickBooks Pro is accounting software used by many Habitat affiliates.

**RESPA**: The Real Estate Settlement Procedures Act reformed mortgage lending, requiring good faith estimates for consumers. It also sets standards and methods for calculating and managing mortgage escrow accounts and affects residential closing documents. Significant changes to RESPA have been adopted by HUD and went into effect Jan.1, 2010. [www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm](http://www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm)

**RFP**: Request for Proposal Document is sent to an entity that may provide goods and services. A RFP details what the organization wants to purchase and asks for a quote.

**SCF**: Statement of Cash Flows is a GAAP report that shows the flow of cash from the Statement of Activities through the Statement of Financial Position.

**SHOP**: Self-Help Homeownership Opportunity Program provides funds for national and regional nonprofit organizations to purchase home sites and develop or improve the infrastructure for volunteer-based homeownership programs for low-income people and families who require sweat equity.
For details on current Habitat SHOP grants, see [http://my.habitat.org/link/2604](http://my.habitat.org/link/2604)

**SOA:** Statement of Activities is the equivalent to an Income Statement or a Profit and Loss Statement in a for-profit organization.

**SOFP:** Statement of Financial Position is the equivalent to the Balance Sheet in a for-profit organization.

**Truth in Lending:** Regulation Z of the Federal Truth in Lending Act requires that residential lenders deliver a written “disclosure statement” to borrowers outlining certain loan terms (interest rate, finance charges, amounts financed, and total of all payments). Significant changes to the disclosures required by the Truth in Lending laws, as well as the timing of these disclosures and updates, are effective for loan applications received on or after July 30, 2009.
1. Habitat for Humanity
International financial policies

1. Generally accepted accounting principles
Habitat for Humanity International (HFHI) has adopted generally accepted accounting principles as promulgated by the American Institute of Certified Public Accountants and the Financial Accounting Standards Board. GAAP is a set of principles that provides general authoritative support within the accounting profession. All major businesses and foundations use GAAP for financial reporting purposes. Consistent use of GAAP allows for comparisons between entities.

Many of the GAAP requirements can be applied at fiscal year-end for reporting purposes such as accruals, mortgage discounting, etc. This enables some smaller affiliates to essentially stay on cash basis accounting during the year and still meet the standards in the Quality Assurance Checklist, Section 5, Financial Management and Legal.

Where appropriate, the FASB regulations are referenced throughout this manual along with references to the Accounting Principles Board opinions.

Also, it is important to know that the Governmental Accounting Standards Board is currently the source of generally accepted accounting principles used by state and local governments in the United States of America. The mission of the Governmental Accounting Standards Board is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors and users of those financial reports.

2. Fiscal year-end
HFHI requires that all affiliates that operate under HFHI’s IRS 501(c)(3) group tax exemption use a fiscal year of July 1 through June 30. HFHI requests that affiliates that do not operate under the group exemption use the same fiscal year of July 1 to June 30.

3. Financial policies overview

All affiliates
All affiliates in the United States, regardless of size, are required to follow basic financial policies. These include:

• Filing the appropriate IRS form annually (990, 990-EZ, 990-N).
• Reporting to HFHI as outlined in this chapter.
• Maintaining formal written fiscal safeguards (see Chapter 2 for more detail).
• Distributing monthly written financial reports to the affiliate’s board of directors (see Chapter 5 for more detail).
• Complying with restricted donation terms (as a matter of policy.)
• Maintaining a written mortgage delinquency policy that requires foreclosure proceedings be commenced on all loans that are past due for more than a specified period, as determined by the affiliate’s board of directors. HFHI recommends that, absent extenuating circumstances, this period be no sooner than 90 days and no longer than 180 days.
• Managing mortgage delinquencies consistently and fairly.
• Submitting an annual statement to the homeowner in January showing the real estate taxes and interest that they have paid and that they may be able to deduct on their income taxes. Obviously, the typical interest payment is zero. However, under the new Subsidy and Sustainability Policy, some affiliates may be using some “zero equivalent
mortgages” that may include interest. If this type of mortgage is serviced by the affiliate, then the annual statement in January is required by the IRS.

- Analyzing escrow accounts annually and adjusting payments accordingly.
- Disclosing special events donation amounts and the value of the goods/services received on the ticket or receipt.
- HFHI strongly recommends that smaller affiliates continually review and update their policies, including the incorporation of additional policies required for larger affiliates as applicable.

The servicing of the mortgage loans that Habitat affiliates establish with homebuyers must meet professional industry standards. The Mortgage Servicing Standards as adopted by US Council in September 2010 are located in My.Habitat 2.0 at:

http://my2.habitat.org/download/g3314b/Mortgage-Servicing-Standards-for-US-Affiliates---Sep-2010

Pursuant to the Subsidy and Sustainability Policy, Section 2.4, these standards will be updated from time to time. These standards shall include explicit procedures for the efficient collecting and recording of mortgage payments and shall include written procedures for responding in the event of late or missed payments. Furthermore, Habitat affiliates are expected to establish systems and procedures that are conducive to homeowners making their payments in full and on time every month, and to taking corrective action promptly in the event of missed payments or other violations of provisions of the mortgage agreement.

Affiliates over $25,000 in revenue or $250,000 in assets

Affiliates in the U.S. with annual contributions or revenues exceeding $25,000 per year or assets exceeding $250,000 are required to comply with additional policy. These policies are recapped below and are explained in more detail throughout this chapter.

- GAAP compliant at fiscal or calendar year-end to include:
  - Use of accrual basis of accounting.
  - Be GAAP compliant entries, including the following:
    - Contributions
      - Accrued or deferred
      - Conditional promises to give
      - Restrictions and net assets
      - Services
      - Materials and property
    - Unrelated business income
      - Special events
    - Construction and sale of houses
      - Construction in Process
      - Down payment assistance grants
      - First mortgages
      - Second mortgages
      - Mortgage discounting
    - Categorization of expenses, including:
      - Program services
      - Management and general (administrative)
      - Fundraising
    - Allocating and distributing expenses
      - Other GAAP-compliant entries recommended by your CPA.
Prepare GAAP-compliant financial statements (see Chapter 5 for more details) at fiscal or calendar year-end, including:

- Statement of Financial Position
- Statement of Activities
- Statement of Cash Flows

Maintain a written record retention policy to meet IRS and/or granting agency minimum standards.

Comply with items listed above for all affiliates.

Affiliates over $250,000 in revenue or $500,000 in assets

In addition, affiliates over $250,000 in annual revenue or $500,000 in total assets are required to:

- Engage a CPA firm to conduct an annual formal independent audit.
- Comply with items listed above for all affiliates and affiliates over $25,000 in revenue or $250,000 in assets.

4. Reporting to HFHI

All affiliates are required to send annually to HFHI a copy of the forms sent to the IRS. This should include all required schedules and the 990-T, if applicable, and the 990, 990-EZ or 990N. In addition, affiliates who have audited financial statements are required to send copies of these documents with the tax return. These are used to prepare a combined financial statement for Habitat for Humanity International and affiliates worldwide. The combined statements are used by donors and nonprofit monitoring and evaluation agencies such as Guide Star, Charity Navigator, etc. to evaluate charities.

Also, affiliates are required to submit quarterly Affiliate Statistical Reports and quarterly House Production Reports. Annually, affiliates must submit the Quality Assurance Checklist and the U.S. Affiliate Covenant as part of the Quality Assurance Program. The QA Checklist requires that the affiliate be in compliance with this Financial Policies and Procedures AOM.

Copies of the 990, 990-EZ, 990-N and audited financial statements, if required, must be sent to HFHI annually when the 990, 990-EZ, or 990-N is sent to the IRS. Mail, e-mail or fax a copy to HFHI.

Mail to:
Habitat for Humanity International
Affiliate Support Center
121 Habitat St.
Americus, GA 31709

E-mail to:
FS_990@habitat.org

Fax to:
229-928-4157

If emailing, HFHI asks that you include your affiliate name and the document(s) attached in the subject line or on the fax cover sheet, for example, “Stickbuilt HFH Audit Report and 990.”

When applying for a FlexCAP loan, a Capacity Building (CB) grant or Self-Help Homeownership Opportunity Program (SHOP) grant from HFHI, affiliates may also need to include another copy of the financial statements and/or 990 or 990-EZ with the application, as required by the individual program. After the initial application for the loan/grant, annual submission of the 990 or 990-EZ and audited financial statements to HFHI can be sent to the Affiliate Support Center as noted above. There is no need to send another copy to other HFHI departments. Additional copies of the audited financial statements may
be required by other entities such as United Way, state support organizations, granting agencies, state and local governments and state organizations.

5. Accrual basis of accounting

HFHI requires the use of the accrual basis of accounting as opposed to the cash basis, although adjustments to convert from cash to accrual are often made at year-end only. It should be noted that GAAP requires the use of the accrual basis of accounting.

Under the cash basis system, revenues are recorded only when cash is received and expenses are recorded only when cash is disbursed. Although it is much easier to record transactions under the cash basis system, some misleading results can be obtained.

A pure accrual accounting system requires that transactions be recorded as they occur. Some affiliates use basic checkbook accounting or a cash basis accounting method during the year and prepare adjustments to update mortgage values and other assets as well as record accounts receivable, accounts payable and other liabilities at year-end.

All affiliates over $25,000 in annual contributions or $250,000 in assets are required to use accrual accounting for their fiscal or calendar year-end financial statements. Reporting is discussed in more detail in Chapter 5.

Example: An affiliate received money for tickets sold for a carnival/dinner in one fiscal year and the carnival/dinner is held in the next fiscal year. If this amount was recorded as revenue when received, it would look as though the affiliate had money "to spare" when in fact the affiliate still has to pay for many of the expenses for the carnival/dinner in the next accounting period.

A similar problem could occur with expenses. For example, an affiliate could be billed for leased office space each month and normally make 12 payments in each year. Now assume that because of a delay in processing the June bill, the affiliate pays the bill a month late (which is in the following fiscal year). Under the cash basis, the current year will be charged with only 11 months of lease expense, while the following year will have 13 months of lease expense. In addition, the financial statements will not show that the affiliate owes the amount of the June bill at year-end.

Another example of a problem is when an affiliate has multiple unpaid invoices related to house construction, as this would not show up using a cash basis.

It was because of problems like this that the accrual basis of accounting was developed. Under the accrual basis system, revenues and expenses are recognized in the accounting period in which they are "earned" or incurred.

Example: The money for the carnival/dinner would not be recognized as revenue until the event is held and all related expenses have been incurred. That does not mean that the ticket sales would not be recorded on the books when received; however, they would be recorded in deferred revenue accounts.

The affiliate accountant would debit Cash and credit Deferred Revenue. The deferred revenue accounts are like liability accounts in the sense that this money is owed or refundable until after the event is held, at which time it has been earned and rightfully belongs to the affiliate. At this point, the affiliate accountant would debit Deferred Revenue and credit Revenues and, thus, recognize revenues.

Expenses that relate to future periods are properly deferred. Carnival/dinner expenses incurred before the event date are also properly deferred or prepaid.
Another common example of cash payments that are not charged directly to expense is the prepayment of insurance premiums. Normally, insurance premiums are paid in advance and cover more than one accounting period. If the total cost of the policy was charged to the period in which the payment was made, expenses would be overstated in that period and understated for the subsequent periods.

Under the accrual basis of accounting, the premium payment would be debited to prepaid insurance, an asset account. Each month, a pro rata share of the insurance cost (the premium divided by the number of months covered) would be debited to expense and credited to prepaid insurance. The monthly credits will reduce the balance in the prepaid insurance account to zero by the time the policy has expired.

Another example given in the discussion of accrual basis accounting is that of leased office space that is used in one accounting period but paid for in the next accounting period. Under the accrual basis, an expense account would be debited and a liability account credited in the period in which the office space was used.

Liabilities can also be incurred when assets are purchased. Under the accrual basis of accounting, the purchase is recorded on the books as soon as the liability has been incurred (i.e., when the asset is obtained), not when the bill is paid.

From the above, we see that under the accrual basis of accounting, financial transactions are recognized in the accounting period in which the substance of the transaction occurs, e.g. when inventory merchandise is received, services are rendered either by the affiliate or for the affiliate, and office space is used, not when cash actually changes hands. As a result, there is not an arbitrary shifting of income and expense to different accounting periods based on the timing of cash receipts or payments. In addition, the assets and liabilities of the affiliate will be properly reflected in the financial statements at the end of the accounting period.

6. Contributions – accrued or deferred

Contributions are generally recorded as received. However, contributions and grants are often given as a written promise. Unconditional grants or contributions are to be accrued as contributions or grants receivable and credit to revenues in the period authorized. This is usually when the award letter for the grant or the written promise to give is received as per Statement of Financial Accounting Standards (FAS) No. 116, #8, and #87.

Conversely, some donors will make a gift with a restriction that it must be matched by other donations. If the donor provides cash in anticipation that their funds will be matched, the offsetting entry to cash will be Deferred Revenue, a liability account. When matching funds are received, Deferred Revenue can be relieved and Contributions credited.

Example: Your affiliate receives a multiple-year pledge of $5,000, payable $1,000 per year for five years. This is recorded as a contribution/revenue in the year the pledge is received and a receivable is created. In the year the cash is received, the pledge receivable is reduced.

7. Contributions – conditional promises to give

FAS No.116, #22, states the following: “Conditional promises to give, which depend on the occurrence of a specified future and uncertain event to bind the promisor shall be recognized when the conditions on which they depend is substantially met, that is, when the conditional promise becomes unconditional. A conditional promise to give is considered unconditional if the possibility that the condition will not be met is remote.”

Example: Certain HUD grants and some state grants requiring that the monies be continuously used for “affordable housing” are not considered conditional promises. From a practical standpoint, these monies will be recycled into more
affordable houses as the mortgages are paid off. For this reason, these grants are considered an unconditional promise and should be recorded accordingly.

SHOP grants are considered conditional. Revenue is recognized when the request for funds and the appropriate documentation is submitted to HFHI. As a practical matter, except at year-end, revenue may be recognized when the funds are received.

House sponsorships are not considered a conditional promise to give. These are considered a temporary restriction, which is covered in the next section.

8. Contributions – restrictions

FAS No. 116, #14 states: “A not-for-profit organization shall distinguish between contributions received with permanent restrictions, those received with temporary restrictions, and those received without donor-imposed restrictions.” Fiscal or year-end Financial Statements for the affiliate must reflect Net Assets for these three categories of donor-imposed restrictions. See Chapter 5 for more details on reporting.

Example: The most common permanent restrictions affiliates receive are buildings or warehouses with a clause that “the title reverts to donor” if the affiliate ceases to use the space.

Endowments are another form of permanently restricted gifts. Endowments and other permanently restricted contributions must be reported separately as a type of net asset.

Temporary restrictions are often attached to contributions in the form of either matching funds or as house sponsorships. A practical way to account for these is to maintain a savings account for temporarily restricted funds. As matching contributions are received or as purchases are made for a sponsored house, monies can be transferred from the savings account for restricted donations to general unrestricted accounts. This simplifies reporting restricted funds at the end of an accounting period since these temporarily restricted contributions are also required to be reported separately as a type of net asset.

Designated funds

If the donor “designates” funds for a particular use, it is a “restricted” donation as discussed above and should be recorded accordingly. The board or management of some affiliates frequently designate funds and call them “restricted” funds. The designation, however, is not donor-imposed.

Example: The board sets aside money for the purchase of a warehouse. This is an internal designation if there are no donor-imposed restrictions. Therefore, there is no consequence in GAAP reporting.

Fund for Humanity

Some affiliates have declared “The Fund for Humanity” to mean that the monies received from mortgages can be used to buy only building materials. Again, this is a designation, not a donor-imposed restriction. Most affiliates understand that these revenues will be used to build more houses, and that includes the cost of land, supervision and administration as well as building materials.
9. Contributions – services

FAS 116, #9 states: “Contributions of services shall be recognized if the services received (a) create or enhance non-financial assets or (b) require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.”

Therefore, donated services under #9(a) do not apply to houses that Habitat builds because those become mortgages and are a financial asset. Consequently, the only instance in which volunteers’ time would be recorded as a value would be for building or enhancing an office or warehouse to be used by the affiliate.

Specialized skills, as defined in #9(b) above, are almost always associated with a trade or profession that requires a license or certification. Accordingly, HFHI suggests limiting this valuation of specialized construction services to those licensed services such as electrical, plumbing and HVAC. The value would be based on what the affiliate usually pays or what is normally charged by the hour or by the job for a particular skill. These and other donated services that are valued should be booked as revenue and in most cases charged to the cost of a house or land.

Other donated services might include surveying and land appraisals, which could be a cost of land or of closing, depending on the reason for the services. Real estate attorney fees may be part of the land purchase costs, but normally attorney and CPA services are Management and General expenses and should be recorded as such with the offsetting entry to revenues. Bookkeeping done by a CPA does not meet the test of requiring the CPA skills to do the work. The same test of having a specialized skill and using it is necessary for all donated services.

FAS No. 116 and the IRS differ on how to treat valuation of donated services. For house pricing purposes, HFHI recommends the above treatment as outlined in FAS No. 116 and the addition of the value of these services to the cost of the house. The IRS does not allow the valuation of donated services to be included in the IRS 990. Therefore, the affiliate must remove these from revenues and expenses or Construction in Process on the balance sheet on the 990. The affiliate can disclose these on the 990 in Program Service Accomplishments and in the narrative section of the appropriate program. Disclosure is highly encouraged.

10. Contributions – materials and property

Donated materials and property are normally to be added to the appropriate asset or expense accounts at the fair market value of the items received. The fair market value of donated land would be debited to the land inventory account, the fair market value of building supplies would be debited to either a building supplies or Construction In Process (CIP) inventory account, and the fair market value of administrative supplies would normally be debited to expenses. The related credit will be to a revenue account. The valuation of goods received is based on what the affiliate normally pays for similar items.

**Example:** The affiliate normally uses a $100 window in its houses. Andersen Windows donates $250 windows for a house. The gift would be valued at $100 per window in Construction in Process.

If an affiliate is given space in a building rent-free or for less than fair market value, the difference between what it pays and the actual fair market value should be recorded both as a contribution of revenue and as a rental expense, according to FAS No. 116. Determining fair market value is often difficult, but the use of reasonable estimates and prudent judgment should enable affiliates to avoid costly appraisals. Affiliates should err on the low end of the reasonable valuation range.

FAS No. 116 and the IRS do not agree on how “the use of materials, equipment, or facilities at less than fair rental value” should be treated. The IRS does not allow the value to be included in revenues or expenses on the IRS 990. The affiliate can disclose these on the 990 in the Statement of Program Service Accomplishments. Disclosure is recommended.

Donated land should be valued equal to the value of comparable land the affiliate has acquired or at fair market value. If the value of a comparable property is used, that value may need to be adjusted for expenses that are incurred to bring the property to a like condition.
Example: A donated property has a condemned house on it that would have to be demolished (the cost of which would decrease its value), delinquent taxes that the city or county will not forgive (also a decrease to value), or a septic tank that will save the affiliate an additional expense (an increase).

The value of the gift to the donor may be greater than the value of the gift to the affiliate as shown in the window example. Therefore, affiliates should not provide the donor with anything that states a value of the gift to the donor.

If the value of a donation is over $500 to the donor, the donor is required to complete an IRS Form 8283 – Noncash Charitable Contributions. If the value of the donation is over $5,000 to the donor, the donor must obtain an appraisal and should request the affiliate sign the IRS Form 8283. Section B of this form contains an Acknowledgement that states in part “that it received the donated property as described…above” and “This acknowledgement does not represent agreement with the claimed fair market value.” HFHI recommends the affiliate use this wording even if donors ask the affiliate to sign their own statement.

Also, whether an IRS Form 8283 is filed or not, the affiliate must file an IRS Form 8282 if the affiliate (donee) or its successor organizations “sell, exchange, consume or otherwise dispose of (with or without consideration) charitable deduction property (or any portion) within three years after the date the original donee received the property.”

11. Other income
“Other income” is revenue and related expenses that are not within the central purpose(s) of the organization. Although these activities are unrelated income, this does not automatically mean they are taxable income. It means they are not related to the program purposes of the charitable organization despite the reality that they may provide substantial funds for charitable programs. From a GAAP financial standpoint, these are normally reported as Other Income net of the related expenses. If they become a significant source of revenue, such as 5 percent, then the auditors may require that the affiliate show the revenue and the costs as a separate line item, although still as a part of revenues.

Some affiliates may be concerned that the IRS considers this type of income taxable as unrelated business income. IRS Publication 598 deals with this issue in detail. Generally, to be excluded and therefore not taxable the activity has to:

- Not be a regular business, e.g., not like serving lunch every day.
- “Be a trade or business that consists of selling merchandise, substantially all of which the organization received as gifts or contributions” or be “any trade or business in which substantially all the work is performed for the organization without compensation.”

Some CPAs have said that “substantially all donated material” as mentioned above is about 87.5 percent of material sold. Courts and the IRS have used the figure of 85 percent when defining “substantially all” when considering other tax issues. However, using 87.5 percent may be a safer approach. If all labor is volunteer labor, the percent of donation or purchase is irrelevant, but when staff is hired, the percent is relevant. For more details, please see IRS Publication 598, which can be found on the Forms and Publications page of the IRS website.


Special events
Special events such as an annual dinner often have an element of donation and an element of goods or services contained in the ticket price. The amount of the goods or services and the donation must be on the ticket or receipt. HFHI recommends printing these on the tickets when appropriate. Substantial penalties can be incurred for not informing donors of this break down between goods or services and the donation. The affiliate should always retain its records of fundraising materials, such as tickets, receipts, solicitations, pledge forms, etc.

For financial reporting purposes, the event-related costs of prizes, food, beverages, servers, renting a hall, etc. (direct expenses) should be deducted from income and only the net income should be shown as Other Income. The cost of advertising, mailing out invitations and the like (indirect expenses) should be charged to fundraising expenses.
Example: A ticket for a dinner costs $50, $20 of which is for the food, service, entertainment and location cost and $30 of which is a donation to the affiliate. Printed on the ticket would be:

- Goods and services received $20
- Donation to affiliate $30

A special breakfast with a $10 ticket cost for goods/services to cover the cost of the breakfast would be recorded as “other income” (after deducting direct expenses of the event), but the $300,000 of pledges and checks generated from the event would be recorded as donations.

If no ticket cost is involved for the event, the pledges and checks are still recorded as donations and the costs related to the event are charged to fundraising expenses.

**Habitat for Humanity ReStore/Thrift stores**

This section will be updated in the next version of this AOM (scheduled for 2011). In the meantime, for information on ReStore operations, consult the ReStore Affiliate Operations manual (AOM) and browse related resources via the My.Habitat Knowledge Center under the topic, ReStore:

http://my2.habitat.org/kc/operations-governance/restore

**12. Sale of houses and mortgages to homeowners**

When a house is sold and title is transferred to a homeowner, a series of transactions must be recorded.

The first set of transactions, the sale of the house, includes recording the revenue for the house price (Sale to Homeowners) and setting up a mortgage receivable. Prepaid closing costs that many affiliates require and the establishment of escrow balances for payment of taxes, insurance, etc. may also be included.

In pricing homes, affiliates should comply with the requirements of and be guided by the best practices in the U.S. Subsidy and Sustainability Policy and Supporting Resources available via My.Habitat at:

http://my.habitat.org/GlobalLink.aspx?GID=g31fde

This would include, but is not limited to:

- Policy 23: http://my2.habitat.org/download/g31fe8/Policy-23---House-Pricing-revised-Jan-2010
- Policy 24: http://my2.habitat.org/download/g31fca/Policy-24---Mortgage-revised-Jan-2010
- Policy Advisory Statement Policy 23:
  http://my2.habitat.org/download/g328d9/0610-Policy-Advisory-Statement-Policy-23
- Policy Advisory Statement Policy 24:
  http://my2.habitat.org/download/g328da/0610-Policy-Advisory-Statement-Policy-24

The closing should be done at or before occupancy, and the first mortgage, along with any second mortgages, should be recorded promptly. Failure to have prices set and closings completed on a timely basis has been a frequent source of problems for affiliates.

The second set of transactions is to transfer Construction in Process inventory costs for the house to Program Services expense (Cost of Construction from CIP). This includes the land cost if it has been carried in a separate inventory account. The following is a link to a spreadsheet that depicts accounting entries to be done upon the closing (house sales and costing entries) available via My.Habitat:


The third set of transactions involves the mortgage discount, which is charged to Program Service expense (Mortgage Discount Expense) and credited to an asset account usually called Unamortized Mortgage Discount. The discount rate is set annually by HFHI. Many affiliates make this entry annually. If an affiliate chooses to record the discount and amortization...
monthly, it will be an estimate and should be adjusted to actual when the rate is set. The following link is to a spreadsheet with sample accounting entries for mortgage discounting available via My.Habitat:

http://my2.habitat.org/download/g318d5/Sample-Mortgage-Discounting-Entries

**Down payment assistance grants**

Several states and cities have grants for first-time homeowners or other types of assistance for people who are eligible for Habitat partnership. Money from these programs is treated as if the homeowner brought his or her own money to the closing. The money represents an increase in cash and reduces the amount of the mortgage from the house price. If the funds are not available at closing, this should be recorded on the affiliate’s books as a receivable from the granting agency, which is cleared when the money is received.

**Construction in process and house costs**

As a construction company, it is appropriate to accumulate house construction costs in a Construction in Process account on the balance sheet until the house is sold. At that time, the affiliate should charge the expense account “Cost of Construction from CIP” and relieve “Construction in Process” to close out the costs of the house.

How the costs are accumulated may differ depending on the activity of the affiliate. Affiliates with a paid construction supervisor or an executive director who handles construction duties may allocate a portion of the annual salary to the cost of each house or they may charge it to Program Services expense and adjust for any supervision-in-process at year-end. Other expenses that are allocable to all houses built are depreciation, warehouse expenses, and bulk materials such as nails and primer. Allocating costs is discussed in more detail later in categories of expenses in this chapter.

**First mortgages**

The first lien mortgage* signed by the homeowner becomes an asset to the affiliate when the house is sold. These mortgages are entered on the affiliate’s books as an asset and should be recorded in the county real property records promptly after closing. Mortgages are normally the biggest class of assets an affiliate accumulates. A reduction is recorded in the value of the asset or the loan balance when the homeowner makes a payment. Mortgage payments are not revenue to the affiliate even though such payments are cash flow to the affiliate that can be used as mentioned earlier in this chapter in the section on Fund for Humanity.

*Depending on the affiliate’s state of operation, a “mortgage” instrument may be called a “deed of trust” or a “deed to secure debt.” References to “mortgage” in this AOM are intended to refer to any such mortgage instrument. Accounting for each type of instrument is the same.

Since this is not revenue/income, it will not show up on the Statement of Activities or Income Report. The Statement of Cash Flows is the best way for an affiliate to see items that affect cash. See Chapter 5 for more information on reporting.

Affiliates are required to comply with Real Estate Settlement Procedures Act (RESPA) and Truth in Lending laws when closing a mortgage. Check with a real estate attorney in your state. Large affiliates closing mortgages worth an aggregate of at least $1 million per year, including any second or third mortgages, are required to follow the regulations of RESPA. For all affiliates, RESPA is recommended as a best practice. For further information, see the Appendix.

**Second mortgages**

If the first mortgage is less than the house appraisal value at closing, a second lien mortgage document should be executed by the homeowner reflecting this difference. This second mortgage, also known as a “silent second,” is a legal document executed to protect the equity in the house, both for the benefit of the partner family and the affiliate. Absent the “silent second,” the homeowner could “flip” the house for a profit and retain all of the artificially created equity (i.e., the equity created by Habitat’s “no profit” pricing structure). In addition, the “silent second” protects the partner family from predatory lenders, who might otherwise refinance the house with a high interest rate mortgage. The “silent second” is a no-interest product, and the payments on the mortgage must be deferred until foreclosure, sale, transfer of title or full payment or refinance of the house or the first mortgage.
Alternatively, a shared appreciation or gifted equity model may be used. In this model, the affiliate protects not just the difference between the purchase price and the fair market value of the house, but any additional appreciation that occurs between the housing sale and the homeowner’s resale or refinancing of the house.

While affiliates should maintain second mortgage information and record the instrument in the county real property records (as you would the first mortgage), the second mortgages should not be recorded on the books. This treatment is based on FAS No. 5, #83, which relates to the accounting concept of conservatism. Since the second mortgage is a contingent receivable, you do not record it on the books because there is significant uncertainty regarding collectability. The only time you would record a second mortgage in the general ledger would be in the event that the first is paid off and the affiliate intends to collect on the second mortgage. If the affiliate will not forgive but will recapture the second mortgage, then it must comply with the Subsidy and Sustainability Policy.

**Renting houses**

HFHI assumes that all Habitat houses are built with the intent that they are sold and a mortgage is issued. It is contrary to Habitat’s mission to rent houses on a long-term basis. HFHI recognizes that there are situations that prevent timely closings of mortgages and that short-term rentals sometimes exist, however, it is strongly recommended that rentals be avoided. Renting a house should never be used to demonstrate a family’s “ability to pay” or “willingness to partner.”

**13. Mortgage discounting**

Although a mortgage loan is issued with a face value equal to the purchase price of the house (less the down payment), this mortgage asset must have an allowance account credited against it because the affiliate is also lending the money at a below-market rate (i.e., zero percent). This below-market rate is an economic cost to the affiliate and benefit to the homeowner that must be recognized in the accounting records according to Accounting Principles Board (APB) Opinion No. 21. The allowance is estimated by discounting the note at the current market interest rate of similar mortgages.

HFHI develops a discount rate once a year on June 30th. The calculation for the discount is a Present Value calculation. The original discount is amortized using straight line amortization over the life of the mortgage. For rate history and calculation methodology, see My.Habitat:

http://my2.habitat.org/download/g329e1/

The accounting theory to support discounting is based on the GAAP requirement that receivables that are contractual rights to receive money in the future at a fixed or determinable date be recorded at present values. Present value is a time value of money concept, in this case the current worth of a series of payments to be received in the future, discounted at compound interest.

The difference between the face amount of the note and its present value is accounted for as a discount, recorded on the balance sheet as a contra account to mortgages receivable and amortized over the life of the note. Although APB 21 prefers another method, for our purposes, the straight-line method (e.g., one twentieth each year of a 20-year mortgage) may be used by affiliates because it is simple to apply and provides for recognition of the discount in interest income over the life of the mortgage.

The effect of discounting on the financial statements is that the mortgage receivable is reduced by the discount amount as noted above and the expense is increased. HFHI recommends that mortgage discounts be charged as Program Services expense to a Mortgage Discount Expense account and each year a ratable amount of the discount should be amortized to a Mortgage Discount Amortization revenue account.

*Example: On a $40,000 loan, the discount is approximately $20,000. The initial discount of $20,000 is written off to expense, and for a 20-year loan, one-twentieth, or $1,000, is taken in to revenue at the end of each year.*

For practical purposes, delinquent or prepaid mortgage payments are not adjusted in the annual amortization. However, mortgage payoffs or foreclosures do result in the remaining unamortized discount balance being closed and taken in to Mortgage Discount revenue.
Mortgage discounting is required by GAAP accounting but as a practical matter does not provide any data that will benefit the affiliate. It can even make it difficult for an affiliate to analyze income and cash flow. Accordingly, we recommend this adjustment be made and recognized only at fiscal year-end. Resources related to mortgage discounting are available via My.Habitat:

http://my2.habitat.org/kc/mortgage-discounting

14. Notes Payable

Many affiliates have taken advantage of the FlexCAP program, its predecessor program or similar state mortgage sale programs to generate funds by borrowing against or selling a portion of their mortgage receivables. These loans are quite often at less than market interest rate or more than zero interest.

The interest expense for these types of loans is often a Program Services cost as long as the money is used to build more houses. This type of interest expense may have to be allocated to Program Services, Management and General, and Fundraising expenses, depending on how the money from the loan is used. See Categories of Expense at the end of this chapter for more details.

The discounting of notes payable for below customary interest rates is the same process and has the same purpose as the discounting of mortgage receivables above. A “Not For Profit Technical Practice Aids” was issued by the AICPA (#6140.05 NPO Accounting for Loans of Cash that Are Interest Free or that Have Below Market Interest Rates), requiring the lender and the borrower to discount the notes at the time of the loan. Over the life of the loan, the borrower will restore the discount by the time the loan is paid off. Again, the benefit of this procedure is dubious for Habitat affiliates, and we recommend it be coordinated with your CPA to handle as a year-end adjustment. Your CPA also can assist you in establishing or validating the HFHI discount rate.

15. Escrow accounts

Escrow accounts are money held in trust for the homeowners to pay regular and predictable home expenses. The affiliate has a fiduciary responsibility to use the funds to pay only expenses agreed upon with the homeowner (e.g., taxes, insurance, termite inspections, etc.). Affiliates should never spend escrow funds to cover operating expenses for the affiliate or co-mingle the money with other funds.

Escrow funds should be in a separate bank account offset by an escrow liability account. The bank account may be more than the liability account if the affiliate has any homeowners who are in a negative escrow position. The minimum amount in the bank account must be the total of the positive escrow balances. As a practical matter, homeowner payments may be deposited into the escrow account rather than splitting checks or money orders at the time of payment. Periodically, the affiliate should transfer the principal portion of the homeowners’ payments into an affiliate account. Some states require interest to be paid on escrow accounts; others require interest only if the affiliate collects interest; others don’t require it at all. Affiliates should check with a local attorney in their state to determine what the law is regarding interest on escrow accounts.

Payments of taxes or insurance can be made through the escrow account or through the regular checking account after transferring cash from the escrow bank account. The escrow accounts are primarily for the protection of the affiliate’s rights by making sure the taxes due get paid and the property is insured. Some affiliates also include an amount for repairs to the house. However, HFHI does not recommend this because it can put the affiliate at risk of violating state and federal laws. If the affiliate collects a maintenance escrow, it should check with a local attorney to see what laws apply. If an affiliate currently maintains maintenance escrow accounts for its homeowners, HFHI recommends closing out the accounts and paying the homeowners their balance.

The amount of the escrow payment needs to be set high enough to cover the annual property taxes, insurance and other escrow costs. The affiliate must take into account the timing of the payments to ensure that the homeowner’s balance never goes below $0. In the event of a late mortgage payment by the homeowner or payments of less than the full amount due, generally late fees have first claim on the money, escrow payments are second, and mortgage principal is last. If this is not the case with the affiliate’s mortgage documents, check with an attorney.
The escrow balance for each homeowner must be reviewed on an annual basis for the requirements of the next year. You will find an escrow calculator on My.Habitat:

http://my2.habitat.org/download/g2f182/RESPA-Worksheet

Affiliates that originate mortgages in an aggregate amount of $1 million or more per year (including the amount of any deferred subordinate mortgages) are required by law to follow the Real Estate Settlement Procedures Act (RESPA). RESPA is a federal consumer protection statute that covers items such as required “Good Faith Estimate” forms and “HUD-1” forms and required escrow procedures.

According to RESPA, if the surplus in an escrow account is less than $50, an affiliate may apply the surplus to reduce the amount of an escrow payment of the homeowner or may return the surplus to the homeowner. If the surplus in escrow is more than or equal to $50, the affiliate must return the surplus in escrow to the borrower within 30 days of performing an escrow analysis, although the affiliate may inform the homeowner that the homeowner may elect to use that refund to reduce the principal or have it credited against future escrow payments. RESPA’s escrow rules for overages will apply only if a homeowner is current (i.e., the homeowner’s payments are received within 30 days of the payment due date) at the time of the escrow account analysis. Therefore, if a borrower is delinquent, the overage rules under RESPA will not apply. However, an affiliate must consult the mortgage loan documents to determine whether any escrow overages may be retained and applied to the principal in arrears or must be returned to the homeowner.

Mortgage payments can be increased for any escrow deficiency that exists. It is good practice to send each homeowner an annual statement of the escrow account. HFHI recommends that affiliates consult a local attorney to determine the requirements of their state and the appropriate options.

For more information on RESPA, see the Appendix.

16. Mortgage delinquencies

Affiliates should manage their mortgages and have a written policy in place to deal with homeowners who become delinquent on their mortgage. The plan should be enforced consistently and fairly and should include foreclosing on the home if the loan becomes significantly delinquent (three to six months, as determined by the affiliate’s board of directors). It is the affiliate’s responsibility to ensure that homeowners and potential homeowners are made aware of this policy. Not having a consistent policy that is enforced for handling mortgage delinquencies may cause difficulties for the affiliate and will reduce the funds available to provide housing for other families. Information on mortgage delinquencies should be included in monthly board reports.

Affiliates may be requested by their auditors to provide an allowance for bad debts or uncollectible accounts. These may occur for mortgages or for pledges collectable. Most affiliates do not make a provision for either mortgages or pledges because the amounts may not be significant for reporting purposes and are difficult to determine.

17. Foreclosure/deed in lieu

Habitat for Humanity believes in making every effort to work with homeowners to keep the partnership with the family intact. Unfortunately, in some situations, the homeowner is unable or unwilling to continue to make payments on the Habitat mortgage. Although legal foreclosure proceedings are an option at that time, a voluntary, non-judicial “deed in lieu of foreclosure” will in many instances be preferable for both the affiliate and the partner family. Under a “deed in lieu” transaction, the homeowners sign over their interest in the house in exchange for a release from liability. As an additional incentive to sign a deed in lieu, the affiliate may offer to assist the homeowner with moving expenses, which is sometimes called “cash for keys.” This should be done in two steps: one-half of the money when the deed in lieu paperwork is signed, and one-half when the house is vacated in good condition. The affiliate must be cautious in accepting a deed in lieu and carefully review the title to make sure there are no other liens or claims on the title. If the affiliate accepts a deed in lieu, it will be responsible for all liens filed before the transfer.

Affiliates should always consult with their attorney when preparing for or commencing foreclosure proceedings or when accepting a deed in lieu. This is a link to a resource on My.Habitat that contains accounting entries for a foreclosure and deed in lieu:
http://my2.habitat.org/download/g318d9/Foreclosure-Entries

18. Cost of tithing
In recognition of, and commitment to, the global partnership of Habitat for Humanity, an affiliate is expected to contribute (tithe) at least 10 percent of its cash contributions (excluding cash restricted to local use only and excluding gifts-in-kind) to Habitat’s international work. This is a Program Service expense and is a voluntary award or grant. It is not affiliate dues for IRS reporting. The IRS 990 instructions state that payments of this nature should be reported on the affiliate’s 990 as part of Program Services. “Payments to affiliates” is for dues or quotas paid for unspecified purposes. Tithes are normally specified for building houses internationally and are a voluntary award to other affiliates.

19. Fixed assets and depreciation
When an affiliate purchases land, buildings and equipment for its use, it clearly has assets (possessions of long-term value) that should be included in the balance sheet. The affiliate should have a capitalization policy that is reviewed annually. For example, the asset should have a useful life of at least three years and a unit cost of over $1,000 to be capitalized.

Detailed records (listing cost, the expected useful life or depreciation rate, the estimated salvage value, and the accumulated depreciation) should be maintained for all individual fixed assets. At the time of disposal, these records provide the information regarding cost and accumulated depreciation from which to make the appropriate entries. These detailed records should be reconciled to the general ledger at least annually.

Affiliates may want to track fixed assets that are not capitalized but charged directly to expense. These could be tracked in a separate ledger or by keeping a copy of the receipts. Keep the serial number of the item for insurance tracking purposes.

20. Categories of expense
The IRS 990 return requires expenses to be classified by various types of categories (e.g. salaries, supplies, legal fees, etc). These categories are typically shown on the chart of accounts for the affiliate. In addition to these classifications, FAS No. 117 and the IRS further require expenses to be allocated across three functions:

- Program Services
- Management and General (Administrative)
- Fundraising

Affiliates often have questions about which costs are assigned to which function. A brief explanation is included below. Do not confuse these functional groups with costs included in the selling price of a house. Some Program Services expenses will not go into the price of the house and some Management and General expenses will. Refer to the U.S. Affiliated Organizations Policy Handbook, Policy 2: House Pricing. This can be found on My.Habitat:

http://my2.habitat.org/download/g31fe8/Policy-23---House-Pricing-revised-Jan-2010

Non-profit analysts, many foundations and sophisticated individual donors often review Administrative and Fundraising costs as a percentage of Total Annual Revenue. Organizations that rate charities look for ratios less than 25 percent for Administrative and Fundraising combined as a reasonable ratio. However, some charity analysts, such as Charity Navigator (www.charitynavigator.org), give their highest comparative ratings to nonprofits that have program expenses in the 85 percent or better range.

Program Services
Program Services are defined as those services that the organization was created to conduct. One of the key aspects of Habitat’s mission is to build and renovate houses, which encompasses a large portion of program services. Habitat’s foundational principles include other areas that are considered program services: family selection and support; providing and servicing loans; and community education and awareness. All of these functions are part of the affiliate’s covenant with Habitat for Humanity International and are program service costs. These costs include not only salaries and related payroll cost of personnel but also the cost of committee meetings, office space and related expenses. Some of these expenses can be
identified by house and some can be allocated or distributed to several houses, but others are not related to house building or house pricing. Allocations and distributions are discussed in more detail later in this section.

**Management and General (Administrative)**
These are expenses for overall operation and management rather than for specific fundraising and program service expenses. These usually include the salaries and expenses for the chief officer of the organization and the chief officer’s staff. If part of their time is spent on fundraising or program services, those costs can be allocated (this will be discussed in more detail at the end of this section). These also include general costs applicable to administration such as general insurance, legal and audit services.

**Fundraising**
These are the total expenses incurred in soliciting contributions, gifts, grants, etc. Allocable overhead costs for fundraising should also be included. The direct costs of a special event are not included in fundraising expenses. These costs are a reduction of the event revenues and are discussed earlier in this chapter under [Special Events](#). The fundraising expenses are limited to: salaries and benefits, space allocation, printing and postage and similar items.

*HFHI occasionally sees affiliates reporting in their financial statements or 990s that zero dollars are allocated to fundraising. Because this is highly unlikely, this can be a red flag with the IRS and major funders.*

**Allocating and distributing expenses**
Some costs can be applied to more than one functional group and therefore must be allocated or distributed to one or more of these functional groups, which include:

- Program Services
- Management and General (Administrative)
- Fundraising

Most house costs are accumulated in Construction in Process inventory until the house is transferred and the costs moved to Program Services expense. These costs are generally identifiable to a specific house such as 121 Faith St. and need no further allocation or distribution. Most purchases for a house fit this profile, as do hiring subcontractors and renting equipment. [Gifts in Kind](#) often are designated for a single house but some may cover several houses.

*Example: Gift-in-kind roofing is received for three houses. It may be charged to the houses at the time of receipt with the cost “distributed” to the final cost objective: the three houses.*

In the case of distributions, the amount of benefit is immediately identifiable to the cost objective, as in the roofing example above.

Some allocations are set-asides that are not identifiable or worth the trouble or effort of identifying them on each bill paid as a cost incurred. Allocated costs are usually accumulated in one category of expense and then charged to all categories of expense on a monthly or annual basis.

*Example: The cost of the executive director (ED) and office costs are often allocated based on how the ED spends his or her time. If the ED usually spends two days a week on construction, family services and creating public awareness; two days on fundraising; and one day on general operations, then those costs would be allocated as 40 percent Program Services, 40 percent Fundraising, and 20 percent Management and General.*

Small affiliates may want to allocate expenses because the only full-time paid person is the executive director, and if his or her expenses are not allocated, it can make the ratio of Management and General (Administrative) expenses to Total Annual Revenue appear unfavorable.
Allocations should be used only when the amounts are significant to your operations (about 10 percent of total expenses or 5 percent of total assets). Below these levels, more effort may be spent allocating than the worth of the information.

21. Independent audits and compilations

An independent audit is a complete review of the affiliate’s finances by a certified public accountant (CPA) who is not connected with the affiliate and who can, therefore, provide an objective opinion about the affiliate’s financial standing.

Habitat for Humanity International requires that affiliates have an independent audit conducted annually if the affiliate has annual revenue above $250,000 or total assets of more than $500,000 (including the value of the affiliate’s mortgages).

It is important that the auditor be truly independent in order to maintain the appropriate checks and balances. The affiliate should not have a member of the board of directors conduct the audit just because the board member is a CPA. Some affiliates have been able to find an independent CPA who will do their annual audit either on a pro bono basis or for a reduced fee. The cost of having this type of audit done should not deter the affiliate from taking advantage of this protection. See Chapter 5 for more information about selecting a firm to perform an audit for the affiliate.

HFHI has reviewed Generally Accepted Accounting Standards and the Financial Accounting Standards Board and stands behind their interpretation of these regulations. On occasion, an affiliate CPA may disagree with HFHI’s interpretation of GAAP or FASB referenced in this manual. The HFHI accounting help desk at 800-HABITAT, ext.7959, is willing to discuss HFHI’s interpretation with the affiliate’s CPA to resolve any differences. In the event that differences remain, the affiliate should rely on the opinion and guidance of the CPA if he or she is preparing an audit for the affiliate and is willing to provide an opinion on the financial position of the affiliate. If the CPA is not preparing an audit and not providing an opinion, the affiliate should rely on the HFHI interpretation of these regulations.

Smaller affiliates that do not meet the above dollar threshold for an annual audit may want to have an annual compilation or review completed by an independent firm or complete an internal review process. At a minimum, this compilation or review must be completed every three years, including a review of internal controls. If you choose not to use an independent firm, you should complete an internal review process. These are discussed in more detail in Chapter 2.

In addition to the above audit requirements, the federal government’s Office of Management and Budget (OMB) requires affiliates that expend more than the minimum required in federal funds in one fiscal year have an OMB A-133 audit. Affiliates must be diligent in determining the source of the funds when receiving state and local funding because many times state and local funding is actually federal funding. This funding must be included in the total when determining if an A-133 audit is required. If an affiliate believes it may have to comply with the A-133 audit standard because of the amount of funds it may expend in its fiscal year, then the affiliate should check with its current auditor to be certain the auditor has the certification to do an OMB A-133, which has to be done in compliance with the governmental auditing standards in the GASB. Not all auditors have this certification.

Copies of audits and compilations must be sent to HFHI as indicated at the beginning of this chapter. This link will display audit-related resources on My.Habitat:

http://my2.habitat.org/kc/audit

22. IRS and state or local reports

Affiliates whose gross annual receipts are less than $25,000 are required to file an IRS Form 990N, or “E-Card.” This must be filed on-line. This return is due by the 15th day of the fifth month after the affiliate’s accounting period ends. Affiliates are required to complete an IRS 990 of one form or another as identified at: http://www.irs.gov
Example:  Affiliate has a June 30 year-end so the return is due by Nov. 15.  An affiliate with a Dec. 31 year-end would need to file the return by May 15.

Extensions of time can be requested to file these returns.  There are substantial financial penalties for filing these returns late.

Each affiliate is responsible for filing their 990, 990-EZ, or 990-N and a 990 T, if applicable, with the IRS.  A copy of the report must be sent to HFHI annually as indicated at the beginning of this chapter.  Each affiliate has a separate employer identification number (EIN), which was required for affiliation.  Do not use HFHI’s EIN.  Your affiliate is covered by group exemption number 8545.  This number should be entered on the first page of your 990, 990-EZ, or 990-N.

There are other IRS, state and local reports for charities that affiliates may be required to file depending on whether they have paid staff, including payroll taxes and sales taxes.  Most states also have annual reports for the Corporation Commission.  Cities and counties may require local licenses or permits.  These reports and any corresponding payments of related taxes should be filed on a timely basis.  Reporting is covered in more detail in Chapter 5 of this manual.

23. Financial record keeping

From a financial standpoint, the following record keeping schedule is required by the IRS or granting agency:

- Records of all receipts and expenditures are to be retained for three years after the date of filing the IRS 990 return.
- If the receipts or expenditures are related to state or federal grants, these should be retained for three years beyond the final report to the granting agency.
- Property: All papers relating to title should be kept for three years after disposition of the property.
- IRS 990, 990-EZ, 990-N returns: Keep copies of any returns filed.

Affiliates should develop their own written record-retention schedules and policies for all types of records including financial, mortgage and personnel records.  It is advisable to consult with a local attorney since different states may have various regulations regarding record retention.
2. Fiscal safeguards and internal controls

1. Fiscal safeguards

All affiliates are required to have written fiscal safeguards regardless of size or affiliation date. Written fiscal safeguards have been part of the new affiliation process for several years. Affiliates must have these fiscal safeguards in writing, and it is best if they are reviewed and updated annually. A fiscal safeguard list to use as a guideline is on My.Habitat:

http://my2.habitat.org/download/g2f112/Fiscal-Safeguard-Sample-List

Habitat affiliates are not immune from theft and fraud. Some affiliates have already learned this lesson firsthand: one is still recovering from the loss of more than $100,000. Believing that such incidents “can’t happen in my affiliate” is not a realistic or responsible plan of action. Affiliates are responsible to donors and the general public for maintaining fiscal safeguards. Even the most stringent regulations may not prevent theft, but sound fiscal procedures will make it less likely that someone will be able to embezzle affiliate funds.

2. General financial controls

Internal controls are practices and procedures that reduce the likelihood of theft or error. The affiliate should have set procedures for dealing with cash, bank accounts, protection of the affiliate’s other assets and a system of checks and balances to make sure these procedures are working.

The implementation of financial controls will reduce the possibility of error, mismanagement of funds and fraud. This, in turn, will improve the affiliate’s ability to provide the necessary service and security to donors, partner families and the community. Good financial practices also reduce the possibility that the affiliate will lose credibility within the community.

Basics of financial control

The following are some basic things that can be done to improve the affiliate's financial controls:

- The affiliate should not accept cash for mortgage payments.
- The affiliate should limit access to assets (bank accounts, cash, credit cards, etc.) to certain authorized personnel. Board resolutions should be used to establish or close bank or credit accounts and to change authorized signatures. Signature authority should be reviewed and updated annually and when an affiliate has a change in authorized personnel.
- The affiliate should never allow one person to have sole access to affiliate funds. If that person leaves or is unavailable, it may take considerable time to reestablish authorizations.
- The most important part of any financial control plan is to make sure that there are checks and balances in place. No one person should be entrusted with all of the financial dealings of the affiliate. There should be a process that requires that a person's work is double-checked by a knowledgeable second person. Leaving all of the affiliate's finances or inventory in the hands of one person creates unnecessary risks for the affiliate and undue accountability for that individual.
3. Organization, functions and duties

All corporate powers are exercised by or under the authority of the board, and the board directs the affairs of the affiliates. This rather broad and encompassing mandate has important consequences when it is viewed in conjunction with an individual director’s standard of care. The standard of care generally means that a director shall discharge his or her duties in good faith and with the degree of diligence, care and skill that an ordinarily prudent person would exercise in similar circumstances. In the area of financial issues, the board of directors and the individual director must make informed decisions. Financial oversight, therefore, is a primary responsibility of the board and each director.

Every director must understand the financial position of the affiliate in order to make informed decisions and to provide proper financial oversight. While certain financial tasks requiring specialized skills can be delegated to the treasurer or the finance committee, the board has the ultimate responsibility. This responsibility includes reviewing and comprehending the financial statements of the affiliate, reviewing and adopting a budget, and developing and implementing policies that ensure there are adequate internal controls. A director, therefore, must receive information in a form, which permits him or her to meet this responsibility. Failure to meet this responsibility can result in personal liability for a director. Resources related to board roles, responsibilities and financial oversight can be found via My.Habitat:

http://my2.habitat.org/kc/board

4. Officers

The primary financial officer of an affiliate is the treasurer. The treasurer has general charge of the affiliate’s financial affairs which includes overseeing the maintenance of financial records, providing the board with financial reports, filing necessary reports, overseeing the disbursement of funds, monitoring the affiliate’s budget, and providing for the safekeeping of funds.

The treasurer cannot relieve an individual director of his or her fiduciary responsibilities for an affiliate’s finances. The treasurer, however, plays a vital role in educating the board and each director on the financial status of the affiliate. The treasurer’s report serves an educational role while providing information, which encourages directors to question items and trends. The treasurer’s tools are the financial budgets, reports and statements that he or she prepares. These tools should permit the board to make informed decisions based on relevant information and analysis of that information. Reporting is discussed in more detail in Chapter 5 of this manual.

As custodian of the affiliate’s financial records, the treasurer plays an important role in regulatory compliance. Federal and state agencies require a great deal of financial information provided through various tax returns. The specific compliance issues are discussed below, but the treasurer is generally charged with the responsibility in this area. Although the treasurer may delegate some of the day-to-day record keeping and preparation of statements, he or she may not delegate the responsibility for the processes and the information provided to the board.

5. Finance committee

The affiliate’s finance committee plays an important role because it is charged with the responsibility of overseeing the affiliate’s financial activities including budget and audit functions and providing general guidance to the treasurer. The committee, therefore, assists in developing and presenting the strategic plan and budgets to the board of directors, reviews accounting policies and internal controls of the affiliate, determines the scope of an audit or review of the affiliate’s financial records, and reviews the annual financial statements.

The most important responsibility in this area is the audit function (some affiliates may have separate audit committees). The committee’s audit function protects the treasurer as well as the resources of the affiliate. The audit function is a review and examination of the affiliate’s financial reporting system by either the finance committee or an independent auditor. An independent audit is the preferred method and audits are required for affiliates over a certain size. Chapter 1 outlines these requirements. An audit checks the organization and maintenance of the records and establishes some degree of confidence in the financial affairs of the affiliate. The audit protects the treasurer by providing appropriate feedback from his or her peers. The audit also provides an affiliate’s supporters with some degree of confidence that the affiliate is a good steward of resources.
6. Staff

If an affiliate has hired office staff (e.g., executive director, office manager, or bookkeeper) the staff assists the treasurer and the board in preparing financial information. In addition, the staff may be delegated the responsibility of administering certain policies contained in the budget or adopted by the board. The staff should never be viewed as displacing the board’s or a director’s fiduciary responsibility, particularly in the area of the affiliate’s finances. The staff should administer the policies and programs adopted by the board and should report on the administration of those policies and programs.

In preparing financial reports for the board, the staff should be given appropriate direction from the treasurer and the board. The board and the treasurer are ultimately responsible for the financial affairs of the affiliate. This responsibility cannot be delegated.

7. Separation of duties

In small affiliates, there may not be enough volunteers, let alone employees, to segregate financial duties. Often the treasurer is preparing checks, posting the books, and keeping the sub-ledgers for mortgages - in short, doing it all. It will strengthen the affiliate’s internal controls to have someone else prepare the deposits to the bank and have a different person receive and prepare the bank reconciliation and to have someone other than the treasurer review the documentation for any checks over specific amounts (e.g., $1,000).

Other general controls include ensuring that the treasurer or bookkeeping duties are either rotated from time to time or are performed by someone else during vacations. The affiliate should also establish written policies and procedures. In addition, HFHI encourages affiliates to establish “desk procedures” to ensure consistent handling of transactions. This is especially important when high turnover is anticipated because of the use of volunteers.

8. Conflict of interest

The duty of loyalty requires that an individual director always act in the best interests of the affiliate. This duty requires that each director avoid (or take steps to mitigate) conflicts of interest and that no director take advantage of “corporate opportunities.” This duty also requires that an individual director avoid even the appearance of a conflict of interest, as that could undermine the interests of the affiliate. With regard to a conflict of interest and the receipt of federal funds, it is not sufficient to have the board member recuse himself or herself. Disclosing it is not sufficient.

A potential conflict of interest occurs whenever a director has a significant financial interest in a proposed contract or transaction to which the affiliate may be a party. For example, it would be a potential conflict of interest for a director to sell a piece of property to an affiliate or to provide services to an affiliate in exchange for payment. A potential conflict of interest by itself is not illegal, nor does it create a legal problem. It is the manner in which a board of directors handles such potential conflicts that may give rise to a legal problem. The board has a legal obligation to ensure that the affiliate’s best interests are not compromised because a director has a potential conflict of interest.

As a first step, the board of directors should adopt a conflict of interest policy in order to protect the affiliate. A conflict of interest policy is important because it enables an affiliate's board of directors to operate within the laws and in a manner that is prescribed by good corporate practice. The presence of a written policy will help ensure that each conflict of interest is handled in an appropriate manner if it arises.

The conflict of interest policy should identify what constitutes a potential conflict of interest, what steps the director with the potential conflict of interest must take, and what steps the board must take in order to avoid a conflict of interest. For example, the policy might require sealed bidding, a disclosure and approval process for the conflict, and the requirement for the director to recuse himself or herself from deliberation and voting on a conflict transaction.

In addition to potential conflicts of interest, the affiliate should adopt policies dealing with gifts to employees or board members and with nepotism. These policies are necessary in order to prevent any conflicts of interest from developing.

First, the affiliate should adopt a policy stating that a director, employee or volunteer should not accept a gift from anyone doing business or seeking to do business with the affiliate without first disclosing it to the president of the affiliate (or in the case of the president, another board member). The affiliate should set a dollar threshold for this policy (e.g., the policy
applies to any gift with a value over $25 or $50. The purpose of this policy is to ensure that the director’s or volunteer’s judgment is not influenced by the gift.

If an individual receives a gift that exceeds these dollar thresholds, the affiliate could use the gift as part of a fundraising event; give it as an award to the volunteer or employee of the year; or make a similar use of the gift.

In addition, the affiliate should have a clear policy regarding nepotism. Nepotism can cause several problems within an organization. If family members work too closely together (e.g., the board treasurer and the bookkeeper are related), the affiliate may not be able to maintain good financial controls. In addition, hiring relatives has the potential to cause morale problems and questions of unfair treatment within the organization.

**Nepotism may arise in several situations. These include:**

1. The board wants to elect the spouse or child of a director to the board.
2. A director wants to apply for a job with the affiliate.
3. A director or a close relative of a director wants to apply for a Habitat house.
4. A director wants to get a job with the affiliate for his or her child or spouse.
5. The affiliate wants to hire the relative of a current employee.

In some of these cases, the conflict of interest is so significant the board should avoid these situations completely. In other cases, the potential for a conflict of interest can be avoided, provided the affiliate is careful to ensure that no undue influence is exerted in the process. However, each of these situations has the potential to cause difficulties with the affiliate and must be dealt with appropriately.

Another potential conflict of interest is having the affiliate’s important financial decisions made by people who are closely related to each other. This presents a risk that the financial controls set up by the affiliate may be ignored and funds may be misused if immediate family members or close relatives work directly for each other.

The board must exercise caution to see that these safeguards are not compromised. It is important that close relatives do not have a disproportionate influence on the finances of the affiliate. Under no circumstances should close relatives serve as the president of the board and as either the secretary or the treasurer.

For additional information on conflicts of interest, typical scenarios for conflicts and how to resolve them, and a sample policy, please read the HFHI conflicts memo available via My.Habitat:

http://my2.habitat.org/download/g32e56/HFHI-Legal-Advisory--Conflicts-of-Interest-Feb-2009

### 9. Cash and related accounts

**Cash**

The affiliate may find it useful to keep a limited amount of petty cash (e.g. $200-$500) on hand. These funds should be kept secure and controlled by one person. Only approved expenses with a receipt should be reimbursed out of petty cash. If money is advanced prior to a purchase, the person receiving the money should sign for the funds and be required to return with an itemized receipt for settlement. It is best if purchases from petty cash are limited to small purchases under $25. Larger amounts should be reimbursed by check. Petty cash should never be used to cash checks or for personal use. Petty cash accounts may be a constant balance account on the affiliate’s financial statements. Expenses are recognized when the petty cash account is reconciled and replenished. Petty cash should be reconciled when the fund needs to be replenished or at the end of every month.

Some homeowners want to make their mortgage payment in cash. This should not be allowed. It is best to insist that mortgage payments be made by check, money order or cashier’s check to reduce the exposure of cash being handled. A delinquent homeowner who wants to pay with cash is not going to be sent away to get a money order. However, this should be the exception rather than the rule. Another possibility for handling cash payments is for the affiliate to ask a local bank to service the affiliate’s mortgage receipts on a pro bono basis.
If these options are not feasible, any cash collections made by the affiliate should be done so under the control of two people whenever possible (one counts the cash while the other prepares a receipt). The affiliate should make sure that the homeowners are issued receipts at the same time. All cash payments should be entered into a computer database the same day if possible. Cash payments should be deposited in the bank at the end of the day on which they are received.

**Bank accounts**

Some basic bank account controls:

- The affiliate should keep its own record (receipts, disbursements, and transfers) of money in its bank accounts.
- The affiliate should not rely solely on bank statements.
- The affiliate should reconcile its own accounting with bank statements on a monthly basis.
- The person who is in charge of maintaining the affiliate's records should not be responsible for reconciling the affiliate's bank statements. This duty should be assigned to someone else.
- All checks received should be restrictively endorsed “For deposit only to Stickbuilt HFH Acct# XXXXXX” immediately upon receipt.
- The affiliate should keep unused checks in a secure, locked location and allow limited access to those checks. These checks should be pre-numbered and the affiliate should be able to account for the numbers.
- The affiliate should require that two people sign all bank checks over a certain amount (e.g., $1,000). We recommend printing this limit on the check stock.
- The total amount of all cash and checks received each day should be compared to the amount deposited in the bank for that day.
- All bank accounts and authorized signers for these accounts need to be authorized by the affiliate board of directors.
- All bank accounts are to be FDIC insured.

**Excess cash**

If the affiliate has significant amounts of cash that it will not be using within the next 90 days, such cash should be maintained in a separate account, not in the affiliate's checking account. These funds should be invested in either a savings account, money market account or a certificate of deposit. Because of federal deposit insurance limitations and to limit the risk of loss if the bank fails, affiliates should know deposit insurance limits and manage the cash in any one bank to ensure the security of the affiliate’s funds. If other types of investments are considered by the affiliate, these should be appropriate investments in organizations with aims and objectives similar to Habitat’s. Affiliates should never choose risky or unsecured investments to increase their return.

**10. Purchasing process**

**Purchase orders**

Some affiliates choose to use purchase orders (POs), which are available in many accounting systems. POs are appropriate for purchases of all construction materials and for other major purchases (e.g., over $2,000). The POs should specify the time and place for delivery so that a receiver can be present and verify receipt. When the invoice comes in, the PO and the receiving receipt become an excellent control system for payment. POs can also prove effective in managing cash flow.

**Subcontracts**

It is important that an affiliate checks a subcontractor’s license. Checking a contractor’s license can tell you:

- The contractor is actively licensed and has a surety bond.
- The contractor submitted proof of liability insurance at the time of application and insurance renewal.
- The contractor submitted information that it carries workers’ compensation insurance to protect its workers on the project.
HABITAT FOR HUMANITY INTERNATIONAL  
FINANCIAL POLICIES AND PROCEDURES AOM 11-10

• Breach of contract complaints filed with the local construction board in the past seven years.
• Construction board disciplinary actions against the business in the past seven years.

You must confirm that subcontractors are properly insured to perform the work of your subcontract and in accordance with the requirements and specified limits as required for subcontractors by your own insurance carrier. Before any work starts, you must obtain a certificate of insurance from the subcontractor that states the types and limits of coverage and the expiration date. The coverage must include workers’ compensation in accordance with state law. The affiliate must be listed as an “additional insured” so that you are covered for losses caused by the subcontractor and so that you receive any notices of cancellation. You must always make sure that you have a current certificate of insurance that has not expired prior to the completion of any work that subcontractor does for you.

You must maintain a file for these certificates of insurance for review by the auditors for your insurance carrier. In the event you don’t have current certificates on file, or the subcontractor does not have adequate workers’ compensation coverage, then your affiliate may be required to pay additional fees to your insurance carrier at the time of the audit. Review your processes for verification of subcontractor coverage annually with your insurance carrier.

You must review the lien laws within your state with your attorney and ensure that you understand the potential obligations that may be imposed by these laws. Because of these laws, you are required to pay subcontractors and suppliers and they are required to pay their suppliers and subcontractors for work performed on your job sites. Even if you have paid a subcontractor, but they have not paid one of their suppliers or subcontractors because of bankruptcy or other reason, your affiliate may be obligated by these laws to also pay these suppliers or subcontractors. Prior to making a payment to any supplier or subcontractor, make sure you have a release of liens from that supplier or subcontractor. You should obtain affidavits of payment and such other proof of payment that will confirm they have paid their subcontractors and suppliers. The processes for protecting your affiliate from liens is dependent upon your state’s laws and not adhering to these laws could result in your having to pay for the same services twice.

Vendors
All new subcontractors must provide a copy of their Workers’ Compensation certificate and a completed W-9 to the affiliate.

11. Mortgages
Over time, the largest asset most affiliates will have is their mortgages and mortgage notes. It is important that the original documents be kept in a safe place such as a safe deposit box at the local bank or in a locked, fireproof filing cabinet at the affiliate’s office. Working copies should be made for the affiliate’s day-to-day use.

12. Other asset controls
Another problem that affiliates may face is the theft of property belonging to the affiliate. Some affiliates have experienced the theft of thousands of dollars worth of equipment and supplies from the affiliate’s warehouse. Just as with the financial controls discussed above, there are steps that each affiliate can take to minimize the risk of becoming the victim of this type of crime. Some controls to put in place:

• Do not leave materials unsecured at a work site over night.
• Always keep materials in a locked area.
• Limit access to this secure area to a few people.
• Have a sign in/sign out system so that tools and construction materials are logged in when they are delivered to the affiliate and then signed out of the warehouse when they are used.
• Conduct regular inventory and equipment checks (at least once a year) to ensure that all materials are properly accounted for. For example, if an affiliate purchases enough insulation for three houses and then builds two houses, an inventory check should show that there is enough insulation in the warehouse to build one more house.
• Inventory checks should not be conducted solely by the construction staff but should involve at least one person not involved in construction.
These steps can help protect the affiliate's property from theft, but theft may still occur. Insurance can play an important role in protecting the affiliate. The affiliate can purchase property insurance that will cover loss from fire, theft or other causes. An analysis of the cost of insurance must consider the deductible amount to decide whether purchasing insurance will be beneficial for the affiliate.

13. Monthly reports and audits

There are two other important methods of maintaining the checks and balances that ensure appropriate financial controls for the affiliate: monthly reports and independent audits.

Monthly financial reports will enable the board to keep up-to-date on the financial dealings of the affiliate. Reports are covered in greater detail in Chapter 5 of this manual, and related resources can be found on My.Habitat: http://my2.habitat.org/kc/reporting

Independent audits are highly recommended for affiliates as another tool for ensuring appropriate financial controls. Affiliates with an annual revenue above $250,000 or total assets of more than $500,000 are required to have an annual independent audit. More information regarding audit requirements is included in Chapter 1.

Even if the affiliate is not required to have an independent audit, it is a good idea for the affiliate to request a compilation by an independent firm. A compilation includes less detail than an audit and does not include an audit opinion. If the affiliate requests a compilation, it is a good idea for the affiliate to ask for a review of internal controls with the compilation.

Affiliates that choose not to have an audit or compilation may want to implement a review process internally. This could include reviewing transactions over a certain amount, sampling of transactions for proper documentation, reviewing bank reconciliations, and complying with written fiscal safeguards.

14. Staff safeguards

- Payroll processing, reporting and tax payments may be handled internally with trained personnel or may be outsourced to an independent payroll servicing company. If the affiliate is paying employees with direct deposit, the person who normally would sign the checks should review the payroll report and supporting documentation - e.g., time sheets and leave requests - and approve each payroll.

- Staff expense reimbursement requests must require supporting documentation and supervisor approval.

- If a corporate credit card is used, monthly statements should be submitted for review with invoice and credit card receipts attached prior to payment by the treasurer.
3. Plans and budgets

The various budgets and financial plans of an affiliate are important tools for the board of directors because they assist the board in directing and managing the affairs of the affiliate. The long-range plan becomes a guideline for preparing the budget for the next year. The affiliate’s budget details the revenue and expense estimates for the next year, reflects the affiliate’s programs and priorities, and is the fiscal plan that allows the board to assess and evaluate the affiliate’s performance systematically and project the activities of the affiliate.

The board sets the financial goals of the affiliate in its strategic plan, which is then expanded into the affiliate’s annual operating budget. In addition, the affiliate should develop a cash flow budget that details the anticipated monthly revenues and disbursements. An affiliate may choose to incur debt as a part of planned growth but should avoid the accumulation of substantial reserves or an endowment. Idle resources are not building houses.

In developing any budget, the affiliate should be guided by Habitat’s commitment to Christian stewardship and faith in God to provide for our needs. This faith, however, should be tempered by realism.

1. Strategic plan

The strategic plan is a long-range financial plan (e.g., three to five years) developed by the board that specifies the program policies and priorities of the affiliate. Although Habitat for Humanity’s one basic purpose is building or rehabilitating houses with those in need, the board must express the affiliate’s priorities in a comprehensive financial plan. The housing plans portion of the local city/county strategic plan may be added as well. This vital planning function of the board cannot be delegated to a committee or a staff person.

The strategic plan presents the program priorities of the affiliate in terms of the number of houses to be built and the other programs that the affiliate may develop (such as volunteer housing). It also can express priorities for personnel (e.g., hiring of an executive director, construction supervisor, etc.) or equipment (e.g., the planned acquisition of computers or tools).

The plan must include not only the expense programs but also the revenue programs. The board must give significant attention to its stewardship ministry that raises the resources necessary to implement the other programs of the affiliate.

The strategic plan detail should be sufficient to permit the development of the annual operating budget that lists projected expenses and income for the fiscal year. The plan should also permit the affiliate to evaluate its programs by providing and documenting the time reference points (milestones) of the affiliate’s plans. The strategic plan can be used by the affiliate to demonstrate its fundraising and program strategies to various constituencies (e.g., donors, foundations, etc.). Resources related to strategic planning can be found on My.Habitat:

http://my2.habitat.org/kc/strategic-planning

2. Annual operating budget

The affiliate’s annual operating budget should be a detailed financial presentation of the projected revenues and expenses of Habitat for Humanity’s ministry. This budget is an expression of the strategic plan, and it must be consistent with Habitat for Humanity’s mission and purposes.

A small committee of board members and staff prepares the affiliate’s annual operating budget. The budget should be approved and adopted by the entire board of directors on an annual basis, usually two to three months before the beginning of the fiscal period. Thus, the preparations for the budget should begin five to six months before the start of the fiscal year. The affiliate should also adopt a capital budget for planned capital expenditures. Once the budget is adopted, the board should monitor the budget through the interim statement of cash flows.

The first step in budget preparation is to identify what the affiliate should be doing as set forth in the affiliate’s strategic plan. The next step is to determine the cost of this mission and the resources needed to fund the mission. A good starting point is the baseline of actual revenues and expenses from the previous 12-month period. This baseline is then adjusted to
reflect anticipated changes in the coming year. The final step in budget preparation is to develop a balanced budget by comparing the expenses and revenues and making reasonable adjustments to either expense or revenue projections.

When the board of directors reviews and adopts the affiliate’s annual operating budget, the board accepts the responsibility for ensuring that the resources are raised and spent appropriately. Once adopted, the annual operating budget becomes the tool used in conjunction with actual monthly financial reports (e.g., interim statement of cash flows) to guide the board in directing the affiliate’s affairs during the fiscal year.

It is important to give the board and management of the affiliate the information that relates budget vs. actual expenses. This can be created using your accounting software or in Excel. Resources related to budgeting are available via My.Habitat:

http://my2.habitat.org/kc/budgeting

3. Support and revenue projections

The affiliate’s revenue budget describes, by source, the anticipated revenue and income of the affiliate. This budget includes projected cash and in-kind support and should reflect restricted and unrestricted funds. The revenue sources should be classified so that they are almost identical to their presentation in the statement of activities. Certain items may be combined while others could be detailed further.

The following example is a basic presentation of the sources of revenue and support for an affiliate. Certain classifications require greater detail if they are financially significant. For example, individual contributions may be detailed into specific programs such as: 1) Carpenter's Club, 2) Annual Partnership Appeal and 3) other. Expressing revenue and support as unrestricted and restricted may be necessary. If your affiliate has a significant ongoing activity to receive donations of building goods and sell them to the general public, you might want a separate set of budgets for that activity.

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<tr>
<td>Indirect, e.g. United Way</td>
<td>15,000</td>
<td>15,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Government grants</td>
<td>44,000</td>
<td>44,000</td>
<td>8 lot infrastructure</td>
<td></td>
</tr>
<tr>
<td><strong>In-kind contributions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Materials</td>
<td>17,000</td>
<td>17,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>8,000</td>
<td>8,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Related organizations HFHI</strong></td>
<td>25,000</td>
<td>25,000</td>
<td>Grant to hire ED</td>
<td></td>
</tr>
<tr>
<td><strong>Sale to homeowners</strong></td>
<td>360,000</td>
<td>360,000</td>
<td>8 Houses</td>
<td></td>
</tr>
<tr>
<td><strong>Special event income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>2,800</td>
<td>2,800</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total support and revenues</strong></td>
<td>385,000</td>
<td>403,300</td>
<td>785,500</td>
<td></td>
</tr>
</tbody>
</table>

In developing its revenue budget, the affiliate uses the actual revenues from the previous 12-month period and makes adjustments as necessary or warranted. The changes should be based upon 1) changes or additions to the development and
fundraising programs, 2) changes in donor cultivation strategies, 3) historical giving trends, and 4) current economic trends. The changes to the previous year’s revenues should be tempered by environmental realities. Mortgage discount amortization was not included in the above projection. Many affiliates include this at year-end only, not for budget purposes.

4. Expense projections

The expense budget presents, by object type, the anticipated expenses of the affiliate such as payroll, rent, etc. Functional categories should also be detailed separately (e.g., Program Services, Management and General, and Fundraising). Certain expenses may be combined, while others may be detailed further.

Certain expense types may require greater detail if financially significant. For example, personnel could be categorized into: 1) salary, 2) benefits, and 3) payroll taxes. Certain professional services can be included as personnel expenses. Other specific categories are utilities (telephone, electricity) and office (supplies, equipment, and rent). In developing its expense budget, the affiliate may allocate certain expenses to the various functions such as Program Services, Management and General, and Fundraising. For example, certain personnel and insurance expenses can be allocated to administration and house-building functions. See the Projected Expenses table on the following page.

Development of the affiliate’s expense budget starts with the actual expenses from the previous 12-month period. These actual amounts provide a reference point or baseline for making any necessary or warranted adjustments.

Fixed and variable expenses: The affiliate must determine which expenses vary with the level of activity performed and which are fixed. Fixed expenses do not vary with changing activity (e.g., personnel expenses like the executive director’s salary or a facility cost like rent). Variable expenses depend on the level of activity performed by the affiliate (e.g., building materials, insurance for building houses, and postage and supplies for the fundraising function).

When preparing budgets, the changes to the previous year’s expenses should take into account both fixed and variable expenses. Other factors that need to be included are the expansion of existing programs or anticipated and planned changes in activities or personnel.

The following Projected Expenses report example is a presentation of the basic types of expenses for affiliates.
## Projected Expenses

<table>
<thead>
<tr>
<th></th>
<th>Program Services</th>
<th>Management and General</th>
<th>Fund-raising</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Houses to be built</strong></td>
<td>8</td>
<td></td>
<td></td>
<td>8</td>
</tr>
<tr>
<td><strong>Personnel</strong></td>
<td>1</td>
<td>2</td>
<td></td>
<td>3</td>
</tr>
<tr>
<td><strong>Cash requirements</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personnel</td>
<td>20,000</td>
<td>36,000</td>
<td></td>
<td>56,000</td>
</tr>
<tr>
<td>Sub contractors</td>
<td>46,500</td>
<td>2,400</td>
<td></td>
<td>48,900</td>
</tr>
<tr>
<td>Materials</td>
<td>260,000</td>
<td></td>
<td></td>
<td>260,000</td>
</tr>
<tr>
<td>Tithe</td>
<td>44,000</td>
<td></td>
<td></td>
<td>44,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>8,000</td>
<td>600</td>
<td></td>
<td>8,600</td>
</tr>
<tr>
<td>Travel</td>
<td></td>
<td>600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td>12,000</td>
<td>3,200</td>
<td></td>
<td>15,200</td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td>900</td>
<td>3,600</td>
<td>4,500</td>
</tr>
<tr>
<td>Postage</td>
<td></td>
<td>600</td>
<td>2,200</td>
<td>2,800</td>
</tr>
<tr>
<td>Utilities</td>
<td>300</td>
<td>2,800</td>
<td></td>
<td>3,100</td>
</tr>
<tr>
<td>Other</td>
<td>1,000</td>
<td></td>
<td></td>
<td>1,000</td>
</tr>
<tr>
<td><strong>Total cash</strong></td>
<td>391,800</td>
<td>47,100</td>
<td>5,800</td>
<td>444,700</td>
</tr>
<tr>
<td><strong>Non Cash Requirements</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gifts-in-kind</td>
<td>25,000</td>
<td></td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>Land inventory used</td>
<td>52,000</td>
<td></td>
<td></td>
<td>52,000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>3,800</td>
<td>2,200</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td><strong>Total non-cash</strong></td>
<td>80,800</td>
<td>2,200</td>
<td></td>
<td>83,000</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td>472,600</td>
<td>49,300</td>
<td>5,800</td>
<td>527,700</td>
</tr>
</tbody>
</table>

Mortgage discount expense was not included in the above projection. Many affiliates include this in Program Services expense at year-end only, not for budget purposes.

In developing its overall budget, the affiliate should encourage each major cost center to develop its own budget. In particular, a budget should be established for each house that will be built by the affiliate and for the fundraising or development program.

### 5. House pricing

Establishing a consistent, thoughtful house pricing strategy is critical for affiliates. Failure to have prices set and closings completed has been a frequent source of problems because of changing expectations of homeowners as the house is built and because actual costs of construction are greater than what the affiliate anticipated. Homeowners tend to compare quality, quantity and home prices among themselves.

For more information on house pricing, see Policy 23, U.S. Affiliated Organization Policy Handbook:

- [http://my2.habitat.org/download/g328d9/0610-Policy-Advisory-Statement-Policy-23](http://my2.habitat.org/download/g328d9/0610-Policy-Advisory-Statement-Policy-23)
- A house pricing calculator is available via My.Habitat:
  - [http://my2.habitat.org/download/g2ed16/House-Pricing-Calculator-per-Policy-23](http://my2.habitat.org/download/g2ed16/House-Pricing-Calculator-per-Policy-23)
6. Job/house costs

Average house costs are developed as part of the affiliate’s house pricing strategy mentioned above. The resulting cost templates should be used during the budget process to develop the house building expense budget. Depending on where the affiliate is located, the costs may be concentrated in the summer or distributed fairly evenly over the year. Similarly, site development costs may have a different schedule from construction. Planning these variables will improve the budget and cash flow projections.

Tracking house costs vs. estimated costs is easy to do with QuickBooks Pro or Premier. This link is to a resource on My.Habitat that will assist with that effort:

http://my2.habitat.org/download/g2f108/House-Cost-Tracking-Example

Resources related to estimating and tracking house costs are available via My.Habitat:

http://my2.habitat.org/kc/house-cost

7. Growth

Habitat is dedicated to helping each affiliate reach its capacity for building. This requires looking at a growth model that takes the affiliate from where it is today to fulfilling the goal of eliminating substandard housing in its area in the future.

For more information on the growth model, see A Field Guide to Affiliate Capacity Building, available via My.Habitat:

http://my2.habitat.org/pages/g3158d/A-Field-Guide-to-Affiliate-Capacity-Building-2009

Increasing house production may require more administration or house cost than in the past. It may also require more, or different, donations and contributions than in the past. These changes become part of the five-year plan and next year’s budget. This growth may also require a contingency plan in case sponsorships do not materialize or are on a different timetable.

8. Cash flow budget

The cash flow budget, an important management and financial tool, examines and plans for anticipated cash income and cash expenses during a period, either monthly or quarterly. This budget is developed by projecting when revenue and expenses will occur during the fiscal year.

Simply dividing the annual revenue and expenses by 12 does not work because revenue and expenses generally do not occur in equal installments over the year. Most expenses are incurred when the affiliate is building, and most revenues will be received throughout the year, typically from November to January. The affiliate, therefore, must make plans based upon the anticipated flows of cash into and out of the affiliate.

The cash flow budget permits the affiliate to determine when it will have the cash necessary to pay its expenses. Months where income exceeds expenses must subsidize the months where expenses exceed income. A simple form of monthly cash flow budgeting takes the opening cash balance for the fiscal year, adds to it the expected monthly revenue for the first month, then subtracts the expected monthly disbursements for that month. The balance carries forward to the next month.

The Cash Flow Projection that follows shows what an entire year might look like. It uses the revenue and expense projections from above.
## Cash Flow Projections

<table>
<thead>
<tr>
<th></th>
<th>Non-cash</th>
<th>Cash</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Support and revenues</td>
<td>223,500</td>
<td>441,300</td>
<td>664,800</td>
</tr>
<tr>
<td>Expenses</td>
<td>83,000</td>
<td>422,700</td>
<td>505,700</td>
</tr>
<tr>
<td><strong>Net revenue</strong></td>
<td>140,500</td>
<td>18,600</td>
<td>159,100</td>
</tr>
<tr>
<td>CIP changes*</td>
<td>-</td>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Payables</td>
<td>(15,000)</td>
<td>15,000</td>
<td>-</td>
</tr>
<tr>
<td><strong>Operating total</strong></td>
<td>125,500</td>
<td>33,600</td>
<td>159,100</td>
</tr>
<tr>
<td><strong>Investing activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage payments</td>
<td></td>
<td>62,400</td>
<td>62,400</td>
</tr>
<tr>
<td>Land purchases or sales</td>
<td>(52,000)</td>
<td>(60,000)</td>
<td>(112,000)</td>
</tr>
<tr>
<td>Equipment purchase</td>
<td>(28,000)</td>
<td>(28,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Investing total</strong></td>
<td>(52,000)</td>
<td>(25,600)</td>
<td>(77,600)</td>
</tr>
<tr>
<td><strong>Financing Activities</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net borrowed on note payable</td>
<td>386,900</td>
<td>386,900</td>
<td>10 Mtg Pledged</td>
</tr>
<tr>
<td>Payment on notes</td>
<td>(2,000)</td>
<td>(2,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Financing total</strong></td>
<td>-</td>
<td>384,900</td>
<td>384,900</td>
</tr>
<tr>
<td><strong>Net increase</strong></td>
<td>73,500</td>
<td>392,900</td>
<td>466,400</td>
</tr>
</tbody>
</table>

**Cash beginning of year** | 34,561  
**Cash end of year**      | 427,461

*Note: Changes in inventory (CIP) or payables can also be planned. Investing and financing activities produce sources or demands for cash. Borrowing $386,900 is an example of planning for expansion in the next year. This may be borrowed to build a warehouse or office or to build an extra 10 houses next year.*

The interim statement of cash flows presents a comparison to the board of the actual revenues and expenses vs. the budgeted revenues and expenses. Any material or significant variances or trends should be examined and evaluated. Certain variances or trends in the cash flow statement may require action by the board.

The affiliate’s ability to manage its cash flow is important in maintaining credibility within the community. The cash flow budget should be used by the board and by the staff as a planning tool to enhance the work of Habitat’s ministry.

An affiliate’s various budgets are essential tools to the board of directors. These budgets permit a systematic and ongoing evaluation of the work of the affiliate. The comparison of expected and actual income and expenses permits an evaluation of programs and priorities. At the same time, the budgets are a plan that requires careful thought to quantify and express the work of the affiliate in dollars. The general program of the affiliate is set forth in a very specific form (e.g., funds raised from specific sources and funds expended on specific items, like building materials and personnel).
9. Managing cash flow

Each affiliate must strive for a balanced budget and cash flow. Each affiliate must also plan for unexpected events and be able to meet contingencies. To avoid a significant disruption of activities, affiliates can establish a credit relationship with a bank or develop an operating reserve.

Negotiating payment schedules with vendors is one way to defer expenses. If the affiliate is a valued customer, most vendors will accommodate seasonal needs. Deferring or reducing expenses requires an affiliate to evaluate its priorities and determine which aspects of the program will be funded with the cash available. Deferring or reducing expenses can significantly disrupt the affiliate’s building program. This disruption may create additional costs such as the loss of credibility or retooling to reach the previous level of activity.

It is recommended that an affiliate prepare a “cash flow forecast” quarterly as a way of evaluating and managing its cash flow.

10. Borrowing

Borrowing is another tool for managing cash flow, though crisis borrowing is undesirable. Affiliates are discouraged from crisis borrowing since it usually does more harm than good. Affiliates are also discouraged from borrowing as an alternative to continued fundraising. On the other hand, planned borrowing for growth or for building more houses may need to be a part of an affiliate’s plan.

Often affiliates pledge their existing mortgages as collateral for loans. Many loan programs impose limits on the percentage of the affiliate mortgage portfolio that may be used for collateral. Check with the individual program for this information. Unpledged mortgages provide a cushion for substituting mortgages if some pledged mortgages become delinquent or in the event of a cash emergency. Interest paid by the affiliate under a mortgage leveraging program is the affiliate’s expense and must not be passed on to any homeowner family.

11. Loan programs

Many states have programs with banks in their state to provide zero- or low-interest loans secured by mortgages of the affiliate. Contact your state support organization or other affiliates in your state to find out about loan programs in your state. The Self-Help Homeownership Opportunity Program (SHOP) grants are also offered to affiliates in the United States by HFHI. Affiliates are required to meet several requirements and must repay 25 percent of the grant.
4. Chart of accounts

1. Introduction to the chart of accounts

A chart of accounts is a list of descriptive names and related numerical codes of general ledger accounts that are used to classify accounting transactions. The recommended chart of accounts (COA) is on My.Habitat in the Knowledge Center:

http://my2.habitat.org/download/g32f19/Example-of-Chart-of-Accounts-for-US-Affiliates

This COA has been specifically designed to:

- Classify the kinds of accounting transactions encountered by local HFH affiliates.
- Meet the accounting and reporting requirements of generally accepted accounting principles as described in the American Institute of Certified Public Accountants' industry audit guide, “Audits of Certain Nonprofit Organizations.”
- Facilitate the preparation of statements for management and board control.
- Provide a consistent means of reporting the affiliate’s financial results.
- Integrate into the IRS 990 reports.

The code structure being used is WXYZ, with the W representing fundamental statement categories such as Assets, Liabilities, Net Assets, etc.

1XYZ Assets
2XYZ Liabilities
3XYZ Net Assets
4XYZ Contributions and Revenues
5XYZ Program Services Expenses
7XYZ Management and General Expenses
8XYZ Fundraising Expenses

The second digit - X - represents similar accounts: 10YZ are all cash accounts. The YZ specifies individual general ledger accounts. For example, petty cash is 1010, operating funds is 1015 and homeowner escrow is 1030.

There is an alternate COA that uses QuickBooks classes (departments or functions) rather than sub accounts to functionalize expenses. It follows the same numbering scheme as the recommended COA:


Both COAs align the accounts to the audited financial statement format and with the IRS 990 “Return of Organization Exempt from Income Tax.” HFHI hopes this will act as an aid or guide to affiliate accountants or auditors for a unified system of accounting and reporting.

The extensive numbering structure may not be necessary for smaller affiliates. For instance, a small affiliate will probably charge most of its Program Services expenses directly to Construction in Process on a house-by-house basis. When the house is sold, these costs will in turn be transferred to the cost of construction expense (or cost of goods sold) account from the CIP asset account.

In addition to the recommended charts of accounts, you can find sample entries for the most common transactions an affiliate may have via My.Habitat:

http://my2.habitat.org/kc/housing-finance/accounting

These sample transactions reflect the most common entries an affiliate may record in its books.
Tracking job/house costs
Tracking job costs by specific house is highly recommended. Using accounting software such as QuickBooks Pro or Premier (QBP) makes it fairly easy for affiliates to track costs in at least three different ways.

- By house address.
- By item.
- By class or category (if you are not using these for functional divisions).

House address
All affiliates need to know how much each house costs. In QBP, you can track the cost of each house by address. This can then be used to ensure the affiliate is pricing per the U.S. Affiliated Organizations Handbook, Policy 23: In QBP, this is done in conjunction with tracking items costs. Policy 23 can be found on My.Habitat:

http://my2.habitat.org/download/g328d9/0610-Policy-Advisory-Statement-Policy-23

Items
Items can be used in QBP to prepare cost estimates (budget) for a house, compare estimated costs with actual costs, and check on job progress. QuickBooks without Pro or Premier does not have the functionality for items. Resources related to QuickBooks can be found on My.Habitat:

http://my2.habitat.org/kc/quickbooks

Item lists may be used for other activities that have costs that should be recorded against a budget, e.g., land development or a fundraising activity such as an annual dinner or golf tournament.

Class or category
Tracking by class or category is a very useful way for affiliates to look at major groups of costs and see at a glance what costs may be out of line or perhaps where to trim costs in the future.

2. Sample accounting entries
There are sample accounting entries available via My.Habitat:

http://my2.habitat.org/kc/accounting

3. Other accounting software
Because many affiliates use QuickBooks Pro or Premier, this chapter has used QuickBooks terminology to describe the recommended process. For those affiliates using Peachtree or other accounting software, the terminology may not be the same, but the functionality should be in the software to collect costs by job and by category. Also, it is important to know that QuickBooks Premier is beneficial for affiliates that want to take advantage of its ability to do fund accounting.
5. Reporting

1. Financial reporting
Financial reporting is both for external and internal purposes. Nonprofit financial reporting is used to:

- Communicate how resources have been used.
- Identify principal programs and their costs.
- Evaluate the affiliate’s ability to carry out its fiscal objectives.

2. External reporting
Most external reporting is done annually and serves to meet a variety of requirements, including those from:

- IRS (990, 990-EZ, 990-N)
- Tax reporting (W-2, W-3, 1099, 1096, etc.)
- Grant applications
- Habitat for Humanity International
- Contributors and other funding sources

3. Internal reporting
Internal reporting serves a different purpose. Internally, reports are used to keep the board, executive director, staff and committees informed about the progress of the affiliate and help them plan. Typically, internal reports are prepared on at least a monthly basis. An affiliate may use different reports for internal and external purposes, or it may use the same reports.

4. Monthly reporting
Monthly reports do not have to conform to GAAP reporting requirements. Rather, they need to impart information necessary to the board and staff of the affiliate. Reports are usually provided shortly after month-end. To be useful, these reports need to be timely, accurate and germane to the recipient’s responsibility.

The treasurer may provide simplified reports or similar financial statements to those required at year-end. Samples of month-end, year-end and simplified reports, as well as performance ratios for affiliates, are available via My.Habitat:

http://my2.habitat.org/kc/accounting/reporting

5. Required financial statements
Affiliates with annual contributions or revenues over $25,000 or assets totaling over $250,000 are required to prepare their fiscal or calendar year-end financial statements according to generally accepted accounting principles.

Samples of year-end statements that comply with GAAP are available via My.Habitat. The sample reports illustrate one of the ways to be GAAP-compliant:

http://my2.habitat.org/kc/accounting/reporting

A list of the required financial statements is shown below, along with a brief explanation of each statement.

**Statement of financial position (balance sheet)**

- Shows what the affiliate owns (assets) and owes (liabilities) and the net balance (assets).
- Measured at a point in time (month-end, year-end, etc.).
Statement of activities (profit and loss statement)
• Shows income and expenses over time.
• Shows categories of income and expense.
• Shows functional areas of expenses as follows:
  o Program Services
  o Management and General (Administrative)
  o Fundraising

Statement of cash flows
• Shows sources and uses of cash over time.
  For internal use, an affiliate would normally include comparison information on many of these reports to compare actual with budget or prior year.

6. Accounting systems
As previously stated, HFHI strongly recommends that affiliate accounting systems be automated. HFHI recommends QuickBooks Pro or Premier accounting software. By using an automated system, the affiliate can provide monthly and annual reporting directly from its accounting system or export the desired information to a spreadsheet program such as Excel.

Whether the affiliate is using an automated accounting system or checkbook accounting (cash basis), monthly financial reporting is important to track the affiliate’s progress and to plan for the future. Sample reports directly from QuickBooks Pro are available via My.Habitat:
http://my2.habitat.org/kc/quickbooks

In addition, an example of a simpler report for smaller affiliates is available:
http://my2.habitat.org/download/g2f10d/Reporting-for-Small-Affiliates

Often affiliates use subsidiary tracking software for tracking mortgages, donors and other monetary transactions. Transactions should be entered in detail in the subsidiary system and only summary general ledger entries entered in the automated accounting system. Subsidiary ledgers must be reconciled to the general ledger monthly.
7. Accounting calendar

The accounting cycle is usually made up of 12 months and includes an annual reporting period. For affiliates who have adopted the recommended fiscal year of July 1 to June 30, a typical accounting calendar of events would look like the following sample calendar:

<table>
<thead>
<tr>
<th>Due date</th>
<th>Person responsible</th>
<th>Task to be completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly by the 15th</td>
<td></td>
<td>Close books for prior month. Provide agreed upon reports to board and staff.</td>
</tr>
<tr>
<td>Jan. 15</td>
<td></td>
<td>Generate annual statement to homeowner verifying tax payments for IRS deduction.</td>
</tr>
<tr>
<td>Feb. 1</td>
<td></td>
<td>Send out RFP for independent audit/compilation or have advance meeting with CPA firm. Establish agreements and expectations. Sign contract for services.</td>
</tr>
<tr>
<td>Feb. 15</td>
<td></td>
<td>Perform annual review of homeowner escrow accounts and make necessary adjustments.</td>
</tr>
<tr>
<td>March 1</td>
<td></td>
<td>Begin budget for next fiscal year. Request functional budgets including house costs, development/fundraising, management and general, family services (including family income levels), etc.</td>
</tr>
<tr>
<td>April 30</td>
<td></td>
<td>Compile information and complete budget for next fiscal year.</td>
</tr>
<tr>
<td>July 31</td>
<td></td>
<td>Close books for prior year. Usually includes: (1) adjustments to accounts payable at year-end; (2) adjustments to record mortgage discount or amortization; (3) reclassifying current portions of long-term receivables and payable; and (4) depreciation adjustments.</td>
</tr>
<tr>
<td>Aug. 1</td>
<td></td>
<td>Begin independent audit or compilation for affiliate.</td>
</tr>
<tr>
<td>Oct. 31</td>
<td></td>
<td>Independent audit or compilation completed for affiliate.</td>
</tr>
<tr>
<td>Nov. 1</td>
<td></td>
<td>IRS 990, 990-EZ or 990-N prepared and submitted. Deadline or extension (for affiliates with a June 30 year-end) must be filed by Nov. 15.</td>
</tr>
</tbody>
</table>

8. Tax reporting and payments

Affiliates do not normally pay income taxes, but there are many cases where reporting or payments are required. Some of the more common reports, forms and disclosures that affiliates must prepare do not require the payment of taxes but must be filed, requested or disclosed on a timely basis. These include:

- IRS 990, 990-EZ or 990-N (annually).
- Contribution receipts (monetary and in-kind).
- Special event tickets (disclose element of donation and of goods/services).
- W-2 and W-3 Wage and Tax Statements.
- W-4 and I-9 for new employees.
- 1099’s and 1096’s for unincorporated service providers, including contract labor.

Many affiliates are required to file additional reports, which may require tax payments. These include:

- Form 941 Employer’s Quarterly Federal Tax Return.
HABITAT FOR HUMANITY INTERNATIONAL  

Financial Policies and Procedures AOM 11-10

- State unemployment reports and taxes.
- Sales taxes for resale store goods.
- IRS 990T for Unrelated Business Income.

Even though payment of taxes is not required on some of the above reports, forms and disclosures, there are substantial penalties for not reporting or for non-compliance in addition to penalties for the late payment of taxes where applicable.

A sample tax reporting and payments calendar for an affiliate with a June 30 year-end follows. Be sure to check with a local CPA to see if this is a complete and accurate list and if it complies with local and state regulations.

### Sample: Tax reporting and payments calendar (Substantial penalties can apply for non-compliance)

<table>
<thead>
<tr>
<th>Due date</th>
<th>Person responsible</th>
<th>Task to be completed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 31</td>
<td></td>
<td>Provide employees with W-2 Wage and Tax Statements for prior calendar year.</td>
</tr>
<tr>
<td>Jan. 31</td>
<td></td>
<td>Submit Form 941 Employer's Quarterly Federal Tax Return for previous calendar quarter payroll taxes.</td>
</tr>
<tr>
<td>April 30</td>
<td></td>
<td>Submit Form 941 Employer's Quarterly Federal Tax Return for previous calendar quarter payroll taxes.</td>
</tr>
<tr>
<td>July 31</td>
<td></td>
<td>Submit state wage and tax forms. Affiliates are 501(c)(3) organizations and are exempt from paying federal unemployment tax. State requirements vary, so check with a local CPA.</td>
</tr>
<tr>
<td>Oct. 31</td>
<td></td>
<td>Send Form 1099 MISC to unincorporated service providers including contract labor and landlords to whom the affiliate paid more than $600 the previous year.</td>
</tr>
<tr>
<td>Jan. 31</td>
<td></td>
<td>If submitting paper forms: Submit W-3 Transmittal of Wage and Tax Statement with Copy A to IRS for prior year.</td>
</tr>
<tr>
<td>Feb. 28</td>
<td></td>
<td>Submit Form 1096 Summary and Transmittal of U.S. Information Returns to IRS for prior year.</td>
</tr>
<tr>
<td>March 31</td>
<td></td>
<td>If submitting electronically, submit W-3 and Copy A of W-2s to the IRS.</td>
</tr>
<tr>
<td>Nov. 15</td>
<td></td>
<td>Prepare and submit IRS 990, 990-EZ or 990-N (annually).</td>
</tr>
<tr>
<td>Nov. 15</td>
<td></td>
<td>Prepare IRS 990T Exempt Organization Business Income Tax Return if needed. This usually applies to affiliates purchasing goods for resale that are more than 12.5 percent of their sales. Estimated tax payments may be required throughout the year, as well as annual reporting. Be sure to check with a local CPA about other possibilities for unrelated business income taxes.</td>
</tr>
<tr>
<td>Dates set on a state-by-state basis</td>
<td></td>
<td>Report and pay sales tax on items sold in a resale store if necessary. Affiliates with this type of operation should check with the state sales tax office or a CPA to see what is required. If payment is required, appropriate dates should be added to this calendar.</td>
</tr>
<tr>
<td>On employment date</td>
<td></td>
<td>Obtain W-4 Employee’s Withholding Allowance Certificate and I-9 Employment Eligibility Verification completed by new employees. Maintain both forms for each employee. Check with your state to determine if you need to complete a new hire reporting form.</td>
</tr>
<tr>
<td>Before first payment for service</td>
<td></td>
<td>Obtain: (1) Current certificate of insurance (if appropriate); (2) Current name, address, phone number, and (3) Taxpayer/employer identification number or Social Security number. Information must be maintained on all unincorporated service providers including contract labor and landlords.</td>
</tr>
</tbody>
</table>
For monetary contribution over $250

Provide required written acknowledgement/statement from affiliate to donor to substantiate the donation for a tax deduction. Indicate that no goods or services were received in turn by the donor. Affiliates may acknowledge smaller donations with the same wording.

When tickets are sold for special events

Print the value of the donation and the value of the cost of goods/services on the ticket. Special events have an element of donation and an element of goods or services contained in the ticket price. Substantial penalties can apply for non-compliance.

When in-kind contributions are received

Acknowledge in-kind contributions by describing the gift but not the value. If the donor claims the value is over $500, the donor must complete a Form 8283 Noncash Charitable Contributions. If the donor claims the value over $5,000, the donor must also have an appraisal and have the affiliate sign on Form 8283 on which the affiliate acknowledges the receipt of goods but does not agree with the claimed fair market value.

9. IRS 990

Affiliates are required to complete an IRS 990, 990-EZ or a 990-N. There are severe penalties for not submitting these forms. These requirements are outlined at the end of Chapter 1.

By law, completed IRS 990 and 990-EZ forms are available for public inspection and copying. The instructions for these forms outline the requirements to be met when someone makes a request to the affiliate to see these forms. The affiliate is not required to provide year-end financial statements to the public but may choose to do so.

10. Independent audits

Independent audits are highly recommended for all affiliates. Affiliates with annual revenue above $250,000 or total assets of more than $500,000 are required to have an annual independent audit. Affiliates that expend more than $500,000 in federal funds received by any combination federally-related grant from HFHI (e.g., SHOP, Capacity Building, etc.), and local or state sources that are derived from federal grants (NSP1, NSP2, NSP3, CDBG, HOME, etc.), are required to have a more extensive and expensive OMB Circular A-133 audit.

The requirement for an OMB Circular A-133 relates to the expenditure of federal funds in the affiliate’s fiscal year. Affiliates should be guided by their auditor, but an OMB Circular A-133 may not be required if the affiliate receives $500,000 or more in federal funds in one year and spends those funds over two years. Conversely, an OMB Circular A-133 would be required in the situation where an affiliate received less than $500,000 in consecutive years but spent more than $500,000 in one of those two years.

HFHI suggests the following for affiliates that are negotiating for an independent audit. These tips can also assist affiliates that are already working with an existing CPA firm.

- Send out a request for proposal to prospective CPA firms.
- Solicit RFP for at least a two-year contract with options to extend.
- Solicit RFP only from reputable CPA firms in the affiliate’s service area. It is desirable that the firm be familiar with not-for-profit accounting and construction.
- If an OMB-133 audit is required, affiliates shall follow the procurement standards prescribed by the Grants Management Common Rule. Refer to 48 CFR part 42.
- Review the following with prospective firms to see if the firm understands and agrees with:
  - HFHI Financial Policies from this manual.
  - Internal control recommendations.
  - Financial statement presentation.
- Ask prospects to explain if they disagree with any of the above.
• If the affiliate requires an OMB Circular A-133 audit, request documentation of additional audit steps required for government grants.
• If the affiliate requires an OMB Circular A-133 audit, verify that the audit staff has the professional qualifications and technical abilities to complete this type of audit.
• Request that the firm provide a management letter at the completion of the audit specifying what internal controls need to be improved.
• Before a contract is signed, agree to:
  ○ What the affiliate will provide to the firm by the end of the month following year-end closing (July 31 or Jan. 31).
  ○ What the firm will provide to the affiliate and the dates by which the firm will provide that information to the affiliate.
• Sign a written contract with the firm.

Tips for the audit RFP, engagement letter, and audit outcomes are available via My.Habitat:

http://my2.habitat.org/kc/audit
6. Where to ask questions and find resources

1. My.Habitat

The best place to find information is on My.Habitat. This site was developed to provide Habitat affiliates with a centralized location to find and share all types of valuable information. First time visitors to this site must register. Click on Register and complete the registration form. It will help to expedite registration if you can provide your Affiliate ID. After that, click on Login to gain access to My.Habitat. The Knowledge Center is particularly useful in that it allows you to browse My.Habitat resources by topic, type and region of the world. Contact the Affiliate Support Center if you have problems registering or questions about My.Habitat. The phone number is 877-HFHI-HELP (877-434-4435).

At the time of initial publishing for this AOM (September 2010), the transition to My.Habitat 2.0 is underway and is scheduled for completion in February 2011. Until that time, this is the link to the My.Habitat Knowledge Center:

http://my2.habitat.org/kc

Every effort has been made to ensure that the links published in this manual will remain functional after the transition. If you do encounter a link that is malfunctioning, please use the My.Habitat Feedback tool to let the publishers know. As always, you may contact the Affiliate Support Center for immediate assistance. The phone number is 877-HFHI-HELP (877-434-4435).

2. E-mail and telephone support

For specific questions about accounting matters and QuickBooks, affiliates in the United States can e-mail or call:

accountinghelp@hfhi.org

800-HABITAT (422-4828), ext. 7959
Appendix 1: RESPA memo

This information is current as of the date of the memo. Laws vary from state to state. Please check with your local attorney for compliance with state law and to see if there have been any changes to the law since the date of this memo.

Memorandum

To: U.S. HFH Affiliates

From: HFHI Legal Department

Date: February 15, 2008 (updated March 2010)


The Real Estate Settlement Procedures Act of 1974 (RESPA)\(^1\) is a federal consumer protection statute that creates uniform disclosure and settlement procedures for residential real estate mortgage transactions. RESPA applies to many Habitat for Humanity affiliates. This memorandum summarizes the statute’s major provisions, with emphasis on the restrictions pertaining to escrow accounts and the new regulations recently enacted under RESPA.

An affiliate should consult with its attorney regarding the precise application of RESPA to the affiliate’s specific real estate settlement practices and to develop a compliance plan. RESPA compliance can be difficult and, due to the ongoing escrow account maintenance provisions, RESPA provisions must typically be observed throughout the entire term of the mortgage.

I. EXECUTIVE SUMMARY

In 1974, Congress enacted RESPA to help protect consumers from unfair practices during the home-buying and loan process. RESPA has three primary goals. First, by requiring certain disclosures, RESPA helps homebuyers become better shoppers for services relating to the home-buying process, such as legal work, credit checks and inspection services. Second, RESPA prohibits “kickbacks,” referral fees and other abusive business practices that unnecessarily increase closing costs to homebuyers.\(^2\) Third, RESPA limits the amount that homebuyers are required to place in escrow accounts intended to ensure that sufficient funds are available to pay real estate taxes, insurance and other charges related to the real property.

Significant new RESPA regulations were published Nov. 17, 2008, and went into effect Jan. 1, 2010. The primary focus of these new regulations was to update the Good Faith Estimate (GFE) and HUD-1 settlement statement forms that are required to be used under RESPA, and also to change the required timing on the delivery of a GFE. These recently enacted regulations are discussed in further detail in Section II below.

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\(^1\) 12 USC § 2601 et seq.

\(^2\) Closing costs are expenses (other than the price of the property) incurred by buyers and sellers in transferring ownership of real property. These costs normally include an origination fee, an attorney’s fee, real estate taxes, amounts placed in escrow, fees for inspections and surveys, and charges for title searches and title insurance.
A. SCOPE OF RESPA

As a general matter, RESPA applies to “federally related mortgage loans.” A “mortgage loan” is a loan that is secured by a mortgage on residential property that houses between one and four families. This definition includes a “purchase money” or “seller finance” loan, such as a Habitat mortgage. A “federally related” mortgage loan includes the following:

1. A mortgage loan made by a lender that makes residential real estate loans aggregating more than $1 million per year.
2. A loan that is made in whole or in part, or is insured, guaranteed, supplemented or assisted in any way under or in connection with a housing or urban development program administered by HUD or a housing or related program administered by any other officer or agency of the federal government.
3. Any loan that is made in whole or in part by a lender that is either regulated by or whose deposits or accounts are insured by any agency of the federal government.\(^3\)

It is clear that the RESPA rules must be observed by Habitat affiliates that originate mortgage loans aggregating more than $1 million per year. In calculating the $1 million threshold, the affiliate should include the face amount of all first mortgages, along with any “silent second” or other deferred or nondeferred subordinate mortgages held by the affiliate. Several affiliates have asked whether—for affiliates whose loan originations fall below the $1 million per year threshold—the acceptance of federal funding for a project (such as NSP, HOME or CDBG funding) or the maintenance of FDIC-insured bank accounts could bring an affiliate within the scope of RESPA. Neither the RESPA regulations nor any other published guidance offers a clear answer to this question. After reviewing the legislative history for RESPA and discussing these questions with a HUD representative, HFHI is of the opinion that, as a technical federal law matter, RESPA applies only to affiliates that originate mortgages (including all first mortgages, second mortgages and other deferred subordinate mortgages) having an aggregate face amount of at least $1 million per year.

It is important to note that, although RESPA is a federal law, some states have adopted laws that establish a lower threshold for required compliance. As a result, even affiliates that do not meet the $1 million threshold should consult with local counsel to confirm whether state law might still require RESPA compliance.

Although affiliates that originate less than $1 million per year in mortgages may not be legally required to comply with RESPA, affiliates should nevertheless consider complying with RESPA as a best practice. There are a number of justifications for this course of action, including the following:

- Compliance with RESPA is standard operating procedure in the residential real estate industry.
- Some state or federal subsidy providers may require compliance with RESPA as a condition to granting a subsidy.
- Some affiliates may have origination, servicing or other arrangements in place with third parties that are required to comply with RESPA and that may similarly require affiliate mortgage procedures to comply with RESPA.
- If an affiliate later chooses to leverage its mortgages through a loan or discount program, the lender or purchaser may not be willing to accept mortgages that were not originated or administered pursuant to RESPA.

In addition, if there is any chance whatsoever that an affiliate will exceed the $1 million threshold in a year, then the RESPA rules should be followed for all mortgages originated during that year.

B. HELPING HOMEBUYERS BECOME BETTER SHOPPERS

\(^3\) 24 CFR Ch. 3500.2(1)(ii) (2009).
RESPA requires that homebuyers receive disclosures at various stages in a residential real estate transaction. These disclosures provide homebuyers with detailed information regarding closing costs, the lender’s servicing and escrow account practices, and any business relationships between providers of settlement services.

1. Disclosures at Time of Loan Application

Three important disclosures are required to be given within three business days after a homebuyer submits an application for a mortgage loan:

a. The lender must deliver to the homebuyer (or place in the mail) HUD’s new settlement cost booklet titled “Shopping for Your Home Loan,” which contains useful information about the home-buying process.4

b. The lender must deliver to the homebuyer (or place in the mail) a Mortgage Servicing Disclosure Statement, which discloses to the homebuyer whether the lender will service the loan or transfer it elsewhere for servicing and provides information regarding how consumer complaints will be handled.

c. The lender must deliver to the homebuyer the new HUD GFE, which contains an itemized estimate of all costs that the homebuyer is likely to pay at settlement.5

For each of the above disclosures, if the lender rejects the loan applicant within three business days of receiving an application, RESPA does not require the lender to provide these documents.

For purposes of RESPA, an application for a mortgage loan is considered to be an “application” (triggering the lender’s obligation to deliver the above disclosures) when a lender has received all of the following information: (1) borrower’s name; (2) borrower’s monthly income; (3) borrower’s Social Security number; (4) property address; (5) estimated value of the property; (6) the mortgage loan amount sought; and (7) any other information deemed necessary by the lender. Under the Habitat model, items 4, 5 and 6 may not be known until the latter stages of the house construction process. Section II.A below discusses GFE timing issues arising from RESPA’s definition of a loan “application.”

2. Disclosures Prior to Closing

The HUD-1 Settlement Statement, also known as the "closing statement" or "settlement sheet," is a standard form that clearly shows all charges imposed on homebuyers and sellers in connection with the closing.6 Under RESPA, the homebuyer may ask to see the HUD-1 Settlement Statement one day before closing; if this occurs, the settlement agent must give the homebuyer a completed HUD-1 Settlement Statement based on information known at that time.

3. Disclosures at Closing

4 HUD prepares and distributes these booklets to lenders. See www.hud.gov/offices/hsg/ramh/res/Settlement-Booklet-January-6-REVISED.pdf for a copy of the booklet.

5 For the GFE, this disclosure is also triggered when information “sufficient to complete” an application is obtained by the lender, whether or not the information is included in the borrower’s application.

6 The HUD-1 Settlement Statement provides an itemized listing of closing costs, including real estate commissions, loan fees, points and initial escrow amounts. It also sets forth the seller's net proceeds and the homebuyer's net payment at closing. The blank HUD-1 form is published by the Department of Housing and Urban Development. A link to the new HUD-1 form is provided in Section II.B below.
The HUD-1 Settlement Statement will show the actual costs of the transaction. In addition, the homebuyer must be given an Initial Escrow Statement, itemizing the estimated taxes, insurance premiums and other charges expected to be paid from the escrow account during the first 12 months of the loan. It must list both the amount of the escrow payment and any additional monetary “cushion” required by the lender. The Initial Escrow Statement is usually given at closing; however, if the lender delivers the statement to the homebuyer within 45 days of the closing, the lender will still be in compliance with RESPA.

4. Disclosures after Closing

Once a year, the entity that services the loan must give the homeowner an Annual Escrow Statement. This statement summarizes all escrow account deposits and payments made during the servicer’s 12-month computation year. It also informs the homeowner of any shortages or surpluses in the account and the course of action being taken to correct the situation.

If the loan servicer sells or assigns the servicing rights to another loan servicer, a Notice of Transfer is required. Generally, the homeowner must be notified at least 15 days before the effective date of the loan transfer. The notice must include information such as the name and address of the new servicer, toll-free telephone numbers, and the date the new servicer will begin accepting payments. As long as during the 60-day period beginning on the effective date of the loan transfer the borrower makes proper payment(s) to the previous servicer, the borrower cannot be penalized.

C. PROTECTING HOMEBUYERS AGAINST UNDULY HIGH CLOSING COSTS

RESPA requires that affiliated providers of settlement services disclose their business relationship to homebuyers when making referrals to one another. The statute also prohibits certain fees and business practices and places limits on the use of escrow accounts. Finally, RESPA gives homebuyers the right to file consumer complaints with mortgage servicers, including complaints about the handling of escrow accounts.

1. Disclosure

If a provider of settlement services refers the homebuyer to a business affiliate in which the provider has an ownership or other beneficial interest, RESPA requires an Affiliated Business Arrangement Disclosure. This disclosure must be given to the homebuyer at or before the time of the referral. The disclosure must describe the business arrangement that exists between the two service providers and give the homebuyer an estimate of the second provider’s charges. With certain exceptions, the provider making the referral may not require the homebuyer to use the second, affiliated provider.

2. Kickbacks, referral fees and other business practices

RESPA outlaws kickbacks, referral fees and business practices that unnecessarily increase the cost of settlement services. For example, RESPA Section 8 prohibits a person from giving or accepting anything of value for referrals of settlement service business. It also prohibits fee-splitting and fees for services not actually performed. RESPA Section 9 prohibits sellers from requiring homebuyers to purchase title insurance from a particular company.

D. ESCROW ACCOUNTS

RESPA does not require lenders to impose escrow requirements on homebuyers. Nevertheless, RESPA Section 10 helps to manage settlement costs prohibiting a lender from collecting excessive amounts for the escrow account used to ensure payment of taxes, insurance and other charges related to the property.
Each month, the lender may require a homeowner to pay into the escrow account no more than one-twelfth of the total of all disbursements that must be paid during the year, plus an amount necessary to pay for any shortage in the account. In addition, the lender may require a “cushion,” not to exceed an amount equal to one-sixth of the total disbursements for the year.

The lender must perform an escrow account analysis once during the year and notify borrowers of any shortage. Additionally, any surplus of $50 or more must be returned to the homeowner. This provision, which is of particular significance to Habitat affiliates, is discussed in more detail in Section III below.

E. OTHER CONSUMER PROTECTIONS: COMPLAINTS ABOUT SERVICING OF MORTGAGES

RESPA Section 6 provides homeowners with consumer protections relating to the servicing of their loans. Homeowners with mortgage-servicing problems, including escrow account questions, can contact the mortgage servicer in writing and outline the basis for their complaint. The servicer must acknowledge receipt of the complaint within 20 business days. Within 60 business days, the servicer must resolve the complaint by correcting the account or stating the reason for its position. Until the complaint is resolved, the homeowner should continue to make the required payment(s) to the mortgage servicer.

F. RESPA ENFORCEMENT

RESPA is enforced by HUD, which has authority to investigate, hold hearings, and subpoena witnesses and documents. HUD is strictly enforcing all RESPA regulations currently in effect, with the exception of the new GFE and the new HUD-1 regulations. Although the new GFE and HUD-1 regulations went into effect Jan. 1, 2010, HUD has approved a 120-day enforcement delay for these new regulations, meaning affiliates that fall within the scope of RESPA have until May 1, 2010, to implement the new RESPA requirements relating to the new GFE and HUD-1.

In addition, any person who believes a settlement service provider has violated a RESPA provision over which HUD has enforcement authority (primarily Sections 6, 8 and 9) may file a complaint with the Department’s Interstate Land Sales/RESPA Division, located within the Office of Consumer and Regulatory Affairs.

Moreover, homeowners can bring private lawsuits in connection with RESPA violations. Penalties vary depending on the specific RESPA provision(s) violated.

1. **Civil lawsuits**

Homebuyers have one year to bring a private lawsuit to enforce violations of RESPA Sections 8 or 9. Violations of RESPA Section 6 may be brought within three years of the violation. The lawsuits may be brought in any federal district court in the district where either the property is located or the violation occurred.

HUD, a state attorney general or a state insurance commissioner may bring an injunctive action to enforce violations of RESPA Sections 6, 8 or 9 within three years.

2. **Penalties**
RESPA does not provide an explicit penalty for failure to provide the Special Information Booklet, Good Faith Estimate or Mortgage Servicing Statement. Bank regulators, however, may impose penalties on lenders who fail to comply with federal law.

**RESPA Section 6:** A homeowner may bring a private lawsuit (or a group of homeowners may bring a class action suit) against a mortgage servicer who fails to comply with Section 6’s provisions regarding consumer questions and complaints. Homeowners may obtain actual damages, as well as additional damages if there is a pattern of noncompliance.

**RESPA Section 8:** Anyone who violates RESPA’s anti-kickback and unearned fee provisions can be fined up to $10,000 and imprisoned for up to one year. Moreover, that person may be liable to pay the homeowner or other injured party an amount equal to three times the amount paid for the settlement service at issue.

**RESPA Section 9:** A seller who violates RESPA Section 9, which prohibits sellers from requiring the use of a particular title insurance company, may be liable to the homebuyer for an amount equal to three times the amount paid by the homebuyer for the title insurance.

**RESPA Section 10:** For each failure to submit an escrow statement to a homeowner, the lender may be fined up to $75, but no more than $130,000 per year. If the omission is intentional, the fine increases to $110 with no maximum penalty per year. HUD considers each mortgage to be a separate violation. In addition, each day that a violation continues is considered to be a separate violation.

**II. NEW RESPA REGULATIONS**

**A. GFE**

As discussed in Section I.B above, effective Jan. 1, 2010, a lender must deliver to the borrower (or place in the mail) the new HUD GFE no later than three business days after receipt of a mortgage loan application or information “sufficient to complete” a mortgage loan application.

**Items Included in New GFE Form.**

The new GFE is now three pages in length and contains several changes from the previous GFE, including the following:

- On Page 1 of the new GFE, HUD’s recent changes are found under the “Summary of Your Loan” section. This section contains general loan information regarding the principal, interest and term of the loan, but the following fields have now been added: (1) initial monthly payment for principal, interest and private mortgage insurance (PMI); (2) a field where the lender must indicate whether the loan’s interest rate is adjustable; and (3) a field where lenders must provide the full dollar amount to which a monthly payment of principal, interest and PMI (if applicable) can rise if the rate is adjustable.

- The new GFE also makes clear that borrowers can “shop around” for loan services.

- The third page of the new GFE now serves as a worksheet for the borrower’s cost-benefit analysis. It begins with a comparison chart of charges due at settlement, followed by a tradeoff table showing current loan terms and possible changes to costs, and concludes with a chart that allows a borrower to enter in the terms of other GFEs from different lenders so that comparisons can be made when “shopping around.”
Permitted “Tolerances.”

The new RESPA regulations also place significant constraints on the lender’s ability to increase certain closing costs from amounts disclosed in the initial GFE (RESPA uses the word “tolerance” to describe the level of increase that is permitted):

1. **No Tolerance**: The loan origination fee and the transfer taxes **may not exceed** the amounts included on the initial GFE.

2. **10% Tolerance**: The sum of the closing costs for the following services **may not be greater than 10 percent** above the sum of these amounts included on the initial GFE:
   - Lender-required settlement services, where the lender selects the third-party settlement provider.
   - Lender-required services, title services and required title insurance, when the borrower uses a settlement service provider identified by the loan originator.
   - Government recording charges.

3. **Unlimited Tolerance**: All other amounts included on the initial GFE may be revised and may increase at closing.

**Exceptions to Tolerance Limits.**

Notwithstanding the tolerance limits described above, a GFE may be revised if any of the following events occur:

- If “changed circumstances” result in a change in the borrower’s eligibility to obtain the loan, the lender may provide the borrower with a revised GFE within three business days of receiving information sufficient to establish the “changed circumstances.”

- If the borrower requests changes to the loan identified in the GFE that will result in a change in the settlement charges or the terms of the loan, the lender may provide a revised GFE to the borrower within three business days of the borrower’s request.

- If the borrower does not express intent to continue with an application within 10 business days after the GFE is provided, the lender is no longer bound by the original GFE.

- For newly constructed homes, the lender is permitted to include on the initial GFE a “clear and conspicuous” disclosure to the effect that the lender may issue a revised GFE at any time up until 60 calendar days before closing. So long as no Certificate of Occupancy has been issued before the revised GFE is sent out and the revised GFE is sent more than 60 days prior to closing, the lender may send out a revised GFE (this is known as the “new construction” exception).

**Timing of GFE Delivery.**

Timing of delivery of the initial GFE requires careful consideration under the Habitat model. Under general RESPA provisions, an application for a mortgage loan under RESPA is considered made (and disclosures must therefore go out as discussed in Section I.B above) when a lender has the following: (1) borrower’s name; (2) borrower’s monthly income; (3)
borrower’s Social Security number; (4) property address; (5) estimated value of the property; 7 (6) the mortgage loan amount sought; and (7) any other information needed by the lender.

Under the Habitat model, homeowners are almost always accepted into the Habitat program before their homes are built and, in many instances, before their lots are selected. Thus, although a prospective partner family’s application to participate in the Habitat program is a type of “loan application,” Habitat affiliates will often be missing items No. 4 (property address), No. 5 (estimated value of the property) and No. 6 (mortgage loan amount sought) through at least the point at which the homeowner’s application is approved, and perhaps for some time thereafter. As a result, until the property address is known by an affiliate and the affiliate can make a reasonable estimation of the maximum repayable house price, the obligation to deliver the initial GFE is not triggered. Due to the limitations on a lender’s ability to modify a GFE after issuance, it is recommended that Habitat affiliates delay issuance of the initial GFE until the lot or house has been selected and the maximum repayable sales price of the completed home can be reasonably estimated. Within three business days of the date on which these two facts are known, the affiliate must issue the initial GFE.

Prior to issuance of the initial GFE, the affiliate is certainly free to provide informal written summaries of the likely mortgage terms to the partner family and to discuss these terms with the family. It is the issuance of the “formal” HUD-required GFE that potentially limits the affiliate’s ability to make changes in the loan and sale terms later. An adaptable transaction summary form is available via My.Habitat.

http://my2.habitat.org/download/g3237a/Adaptable-Transaction-Summary-Form-for-Estimating-Closing-Costs

Remember that, for new construction projects, the affiliate will retain leeway to modify the GFE up to 60 days prior to closing. So, for new construction projects, there is less risk associated with issuing the initial GFE before all of the necessary terms have been confirmed. For the new construction exception, the affiliate must remember (a) to clearly and conspicuously disclose in the initial GFE that a new GFE may be issued up to 60 days before closing and (b) to provide the revised GFE more than 60 days before closing (and before issuance of a certificate of occupancy for the house).

Where to find the New GFE.

The new HUD GFE can be accessed through the following links:

Instructions for the new GFE are located at the following link:
edocket.access.gpo.gov/cfr_2009/aprqtr/24cfr3500AppC.htm

B. HUD-1

Effective Jan. 1, 2010, closing agents must provide all borrowers with the new HUD-1 Settlement Statement that clearly compares borrowers’ final and estimated costs. The new HUD-1 must be used in any transaction where the new GFE is required. A third page was added to the new HUD-1 that contains a full comparison of the GFE charges and those set forth on the HUD-1 and a final statement of the key terms of the loan (i.e., the principal, interest and monthly payments). This provides a borrower with a quick reference point for clear loan terms after closing.

The following general requirements apply to the new HUD-1:

7 For Habitat transactions, the relevant number would be the total development cost of the house (i.e., the maximum “repayable price” of the house under Policy No. 23), as this will be the maximum amount of the first mortgage.
• The closing agent must state the actual charges paid by the borrower and seller on the HUD-1.
• The closing agent must separately itemize each third-party charge paid by the borrower and seller.
• All origination services performed by or on behalf of the loan originator must be included in the lender’s own charge.
• Administrative and processing services related to title services must be included in the title underwriter’s or title agent’s own charge.
• The amount stated on the HUD-1 for any itemized service cannot exceed the amount actually received by the closing agent for that itemized service, unless the charge is an average charge.

Also, an additional page may be attached to a HUD-1 for the purpose of including recitals and additional information, such as a breakdown of payoff figures, a breakdown of the borrower’s monthly mortgage payments, and the date funds are transferred.

A borrower may view his or her HUD-1 settlement statement during the business day immediately preceding closing. Additionally, after the HUD-1 is completed at or before closing, the closing agent must provide a copy of the completed document to the borrower, the seller and the lender. A lender should retain each completed HUD-1 for at least five years after closing.


III. HABITAT AFFILIATES AND RESPA’S ESCROW LIMITATIONS

A. WHICH AFFILIATES MUST COMPLY WITH RESPA’S REQUIREMENTS CONCERNING ESCROW DEPOSITS?

If an affiliate is required to comply with RESPA, then it is also required to comply with all RESPA requirements regarding escrow deposits.

B. WHAT ARE AN AFFILIATE’S RESPONSIBILITIES REGARDING ESCROW ACCOUNTS UNDER RESPA?

RESPA does not require affiliates and homeowners to establish escrow accounts. It remains the affiliate’s decision whether or not to require homeowners to maintain an escrow account to ensure that sufficient funds are available for payment of property taxes, insurance premiums, and any assessments. Most affiliates do employ escrow accounts, and this is certainly encouraged as a best practice.

Typically, the homeowner is required to pay an initial amount into escrow at closing to establish the account. Additional amounts are included as part of each month's regular payment. RESPA limits the amount of money that the homeowner can be required to deposit in the escrow account and also requires the lender to provide escrow account statements to the homeowner. An affiliate can be fined for failing to comply with these requirements.

1. Amount of Money in Escrow Account

RESPA limits the amount of money that a lender may require homeowners to put into an escrow account for purposes of paying taxes, hazard insurance and other charges related to the property. Each month during the course of the loan, the
A homeowner can be required to pay into the escrow account no more than one-twelfth of the total payments to be issued out of escrow during the year, plus an amount necessary to cover any shortage in the account.

RESPA also allows—but does not require—lenders to maintain a “cushion” to ensure that the escrow account contains enough money to make the payments when they become due. This cushion is limited to one-sixth, or approximately two months, of the total amount to be paid out of the escrow account during the year. Once a year, the lender must perform an escrow account analysis and notify homeowners of any shortage in the account. Any excess of $50 or more must be returned to the homeowner.

HUD regulations require use of the aggregate accounting method. This method generally requires homeowners to maintain a lesser amount in the account than the single-item method used by most lenders.

- Calculating the maximum amount that a homeowner can be required to deposit in escrow: an example from HUD

**New Accounts:** The following steps should help estimate the maximum amount of money that an affiliate may require a homeowner to put into a new account under the aggregate accounting method:

1. List the payment amount for each item that will be paid out of the homeowner’s escrow account, and when the payment will be made, for the next 12 months. Assume for purposes of this example that (1) the closing occurred in May; (2) the first mortgage payment is due in July; (3) real property taxes totaling $1,200 must be paid on July 25 ($500) and Dec. 10 ($700); and (4) a hazard insurance payment of $360 must be paid on Sept. 20. The total amount to be paid out of escrow for the year is $1,560 ($500 + $700 + $360).

2. Divide this total amount by 12 to get an average monthly payment of $130 ($1,560/12 = $130).

3. Create a trial running balance for the next 12 months listing all deposits into the escrow account, all payments out of the account, and when these items are paid.

<table>
<thead>
<tr>
<th></th>
<th>Deposit</th>
<th>Pay out</th>
<th>Account balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>July</td>
<td>$130</td>
<td>$500</td>
<td>-$370</td>
</tr>
<tr>
<td>August</td>
<td>$130</td>
<td>0</td>
<td>-$240</td>
</tr>
<tr>
<td>September</td>
<td>$130</td>
<td>$360</td>
<td>-$470</td>
</tr>
<tr>
<td>October</td>
<td>$130</td>
<td>0</td>
<td>-$340</td>
</tr>
<tr>
<td>November</td>
<td>$130</td>
<td>0</td>
<td>-$210</td>
</tr>
<tr>
<td>December</td>
<td>$130</td>
<td>$700</td>
<td>-$780</td>
</tr>
<tr>
<td>January</td>
<td>$130</td>
<td>0</td>
<td>-$650</td>
</tr>
<tr>
<td>February</td>
<td>$130</td>
<td>0</td>
<td>-$520</td>
</tr>
<tr>
<td>March</td>
<td>$130</td>
<td>0</td>
<td>-$390</td>
</tr>
<tr>
<td>April</td>
<td>$130</td>
<td>0</td>
<td>-$260</td>
</tr>
<tr>
<td>May</td>
<td>$130</td>
<td>0</td>
<td>-$130</td>
</tr>
<tr>
<td>June</td>
<td>$130</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
4. The lowest point in the account balance is -$780 in December. To ensure that there are enough funds to cover this month, the escrow account must start in June with a minimum balance of $780.

<table>
<thead>
<tr>
<th></th>
<th>Deposit</th>
<th>Pay out</th>
<th>Account balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>June</td>
<td>-</td>
<td>-</td>
<td>$780</td>
</tr>
<tr>
<td>July</td>
<td>$130</td>
<td>$500</td>
<td>$410</td>
</tr>
<tr>
<td>August</td>
<td>$130</td>
<td>0</td>
<td>$540</td>
</tr>
<tr>
<td>September</td>
<td>$130</td>
<td>$360</td>
<td>$310</td>
</tr>
<tr>
<td>October</td>
<td>$130</td>
<td>0</td>
<td>$440</td>
</tr>
<tr>
<td>November</td>
<td>$130</td>
<td>0</td>
<td>$570</td>
</tr>
<tr>
<td>December</td>
<td>$130</td>
<td>$700</td>
<td>$0</td>
</tr>
<tr>
<td>January</td>
<td>$130</td>
<td>0</td>
<td>$130</td>
</tr>
<tr>
<td>February</td>
<td>$130</td>
<td>0</td>
<td>$260</td>
</tr>
<tr>
<td>March</td>
<td>$130</td>
<td>0</td>
<td>$390</td>
</tr>
<tr>
<td>April</td>
<td>$130</td>
<td>0</td>
<td>$520</td>
</tr>
<tr>
<td>May</td>
<td>$130</td>
<td>0</td>
<td>$650</td>
</tr>
<tr>
<td>June</td>
<td>$130</td>
<td>0</td>
<td>$780</td>
</tr>
</tbody>
</table>

5. An affiliate may—but is not required to—add a “cushion” to the monthly balances in the basic escrow account. RESPA limits the cushion to no more than one-sixth of the total escrow charges. Thus one-sixth of $1,560 = $260. In this example, when the cushion of $260 is added to the basic escrow amount, $1,040 is the maximum amount a homeowner can be required to place in the escrow account. The account should fall to the cushion at least once during the year (December in this example).

**Existing Aggregate Accounts:** In the example above, during escrow analysis, the affiliate would compare the required amount of $1,040 to the actual balance in the homeowner’s account in June. For example, if the homeowner’s balance is $1,076, there is a surplus of $36. When a surplus exists in an escrow account where the homeowner is current (i.e., the affiliate has received the homeowner’s payments within 30 days of the payment due date), the affiliate’s course of action depends on the amount of the surplus in escrow. If the surplus in escrow is less than $50, the affiliate may apply the surplus to reduce the amount of an escrow payment or may choose to return the surplus to the homeowner. However, if the surplus in escrow is more than or equal to $50, the affiliate must return the surplus in escrow to the homeowner within 30 days of performing an escrow analysis, although the affiliate may inform the homeowner in the information the affiliate sends accompanying the return of the surplus that the homeowner may elect to use that refund to reduce the principal or have it credited against future escrow payments.

**b. Shortages in the homeowner’s escrow account.**

If there is a shortage in the homeowner’s escrow account and the affiliate ends up using its own funds to pay a bill, the affiliate may ask the homeowner for reimbursement. If the shortage is less than one monthly escrow payment, the affiliate has three options: (1) it can allow a shortage to exist and do nothing to change it; (2) it can require the homeowner to repay the shortage amount within 30 days; or (3) it can require the homeowner to repay the shortage amount in equal monthly payments over at least a 12-month period. If the shortage in escrow is equal to or greater than one monthly escrow payment, the affiliate has two options: (1) it can allow the shortage to exist and do nothing to change it; or (2) it may require the borrower to repay the shortage in equal monthly payments over at least a 12-month period.
In the example above, assume the homeowner’s escrow balance is $940 and, thus, there is a shortage of $100. This amount is less than one month's escrow payment, and the affiliate can either allow the shortage to exist and do nothing, require the homeowner to repay the shortage amount within 30 days, or require the homeowner to repay the shortage amount over a 12-month period in equal monthly payments. If the escrow balance is $800, there is a shortage of $240, so the affiliate may either spread the collection of the shortage amount over at least a 12-month period or do nothing and let the shortage exist. If the affiliate in this example spreads the shortage over 12 months, the homeowner’s monthly escrow payment would increase to $150.

c. Escrow Surpluses and Delinquent Homeowners

RESPA's escrow rules for surpluses apply only if a homeowner is current at the time of the escrow account analysis. A homeowner is current if the affiliate receives the homeowner’s payments within 30 days of the payment due date. If a homeowner is not current (i.e., the homeowner is delinquent), the affiliate may retain the surplus in the escrow account and apply it to the principal in arrears only if the terms of the mortgage loan documents allow the affiliate to do so.

d. Other considerations

RESPA does not require lenders to pay interest on escrow accounts. Interest payments may be required under state law, however.

2. Escrow Disclosure Requirements

RESPA requires the affiliate to give the homebuyer an initial escrow disclosure statement at the time of closing and an annual statement every year thereafter. These statements must be provided to the homeowner free of charge; the affiliate may not charge a fee for preparing and submitting statements.

a. Disclosures at settlement

The initial escrow statement is usually given to the homebuyer at closing, but it can also be delivered within 45 days of the closing date. This statement must itemize the estimated taxes, insurance premiums and other charges expected to be paid from the escrow account during the first year of the loan, as well as the expected totals of those payments. The statement must also specify all of the payments that are expected to be deposited into the escrow account by the homebuyer. If the affiliate chooses to include a small “cushion” to ensure that the account contains enough money to make the payments when they become due, this amount must also be clearly set forth.

b. Disclosures after settlement

Each year that the affiliate continues to handle an escrow account, it must give the homeowner an annual statement. This statement must describe the activity in the escrow account for the previous year. It also notifies the homeowner of any shortages or surpluses in the account and of any changes in the escrow payments that the homeowner will be required to pay during the next 12-month period.

The annual escrow statement must recite the amount of the homeowner’s current monthly payment, the portion of that payment that is being placed in the escrow account, the total amount paid into the escrow account during the year, the total amount paid out of the escrow account during the year for taxes, insurance premiums and other charges, and the balance in
the escrow account at the end of the year. The affiliate must give this statement to the homeowner at the end of each one-year period or within 30 days thereafter.

3. Affiliate’s Responsibilities in Making Payments from Escrow Accounts

An affiliate’s responsibilities regarding escrow accounts go beyond providing disclosure statements to homeowners and minimizing the homeowners’ escrow deposits. The following paragraphs touch on several other issues of concern.

a. Timely payments

RESPA requires lenders to make payments from the escrow account on time (on or before the deadline) to avoid a penalty. This is required as long as the homeowner’s payment is not more than 30 days overdue. If the affiliate makes a late payment that results in penalties, the penalties cannot be charged against the homeowner’s account. For example, if the affiliate does not make timely payments for insurance and the insurance is canceled, the homeowner can bring a private lawsuit for any injuries suffered on account of the affiliate’s negligence.

b. Homeowner complaints

RESPA gives homeowners the right to contact the affiliate in writing when they have questions or concerns about the handling of their escrow loan account. If this occurs, the affiliate must acknowledge the homeowner’s letter or “complaint” within 20 business days. The affiliate must resolve the situation within 60 business days by correcting any errors in the escrow account, or by giving the homeowner a statement explaining why no corrections are needed. The homeowner must continue to make mortgage payments during this time.

4. Enforcement

As previously noted in Section I.F above, enforcement of RESPA is handled by HUD’s Office of Consumer and Regulatory Affairs – Interstate Land Sales/RESPA Division. This office may fine affiliates falling under the scope of RESPA for any failure to comply with RESPA’s requirements. The fines vary depending on the nature of the violation.

IV. ADDITIONAL RESOURCES

The Real Estate Settlement Procedures Act can be found at Title 12 of the U.S. Code, Sections 2601 through 2617 (12 U.S.C. § 2601 et seq.) or at www.hud.gov/offices/hsg/ramh/res/respa_st.cfm on the Internet.


HUD also has an informative RESPA website at: www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm.

An explanation of RESPA’s escrow provisions can be found at: www.hud.gov/offices/hsg/ramh/res/respafaq.cfm.

Finally, according to its website, RESPA questions can be sent to HUD via this e-mail address: hsg-respa@hud.gov.