



U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

451 7<sup>th</sup> Street, SW, Suite 6222  
Washington, DC 20410  
www.hud.gov espanol.hud.gov

Name  
Address  
Address  
Address

**Subject:**        ***2006 M2M Accounting Q&A's***  
                         ***Mark to Market (M2M) Full Restructuring Financial Reporting and Compliance***

Dear (Owner/Agent) and/or Owner's Accountant:

**Background.** On October 1, 2004 HUD created the Office of Affordable Housing Preservation (OAHP) as the successor to the Office of Multifamily Housing Assistance Restructuring (OMHAR) in the administration of the Mark to Market (M2M) program, including oversight of the portfolio of HUD-held Mortgage Restructuring Notes ("MRNs") and Contingent Repayment Notes "(CRNs)". In this capacity, OAHP and HUD's Post-Closing Portfolio Management (PCPM) contractor (currently RER Solutions, Inc.) routinely review post-restructuring property operations and financial reporting.

**Purpose.** We address below some unique accounting issues associated with this portfolio. Two letters covering important and substantially different topics in post-M2M accounting have been sent each of the past two years. Based on feedback, and a significantly lower incidence of errors in the 2003 and 2004 Annual Financial Statements (AFS), these prior Q&As proved timely and useful to owners and accountants. See OAHP's web site <http://www.hud.gov/offices/hsg/omhar/mhrowner.cfm> for the Post M2M Accounting and Audit Questions. Q&As in both the 2004 letter and the 2005 letter continue to be applicable. We trust that the following Q&A will be equally valuable. Accounting issues unique to the Portfolio Reengineering Demonstration Program (DEMOs) are addressed in separate DEMO guidance also posted at the above website.

### ***2006 M2M Accounting Questions and Answers.***

1. ***Q: I received correspondence notifying me of an error made in calculating Surplus Cash in a prior year's AFS. Must I re-file for that year? How should I document the adjustment? Does it matter if the revision changes the payment due on my MRN?***

HUD does not require you to amend or re-file the prior year AFS, in fact HUD discourages you from doing so. The owner should submit a revised Computation of Surplus Cash in hard copy form to the HUD Project Manager(PM). The revised Computation of Surplus Cash should also be entered in the footnotes of the project's next AFS along with an explanation as to why the revised calculation was required. That footnote should identify and summarize all such correspondence from HUD and/or HUD's contractors regarding adjustments to prior year AFS, whether or not they resulted in additional payments to HUD on the M2M debt. This is applicable whether or not the payment amount on the MRN changes.

## 2006 M2M Accounting Q&As

Page 2 of 5

2. ***Q: After reviewing your M2M Accounting Q&As, I believe the amount due on my MRN was incorrectly reflected in my prior year AFS and thus I have made an overpayment to HUD. What should I do to resolve this?***

Please do not re-file or amend your AFS. When HUD's PCPM contractor reviews your AFS they will note any adjustments to the M2M payment (up or down) and provide specific guidance on how to proceed. We recommend that the excess payment be retained by HUD, as the excess payment will simply result in less Surplus Cash (and a smaller payment) in the following year. However, if the overpayment is in excess of \$1000, HUD will consider requests for refunds submitted in writing to the M2M note payment address specified in your Note (HUD's Chicago Lockbox), including all relevant information. HUD's PCPM contractor will determine if an overpayment indeed occurred, and make a refund recommendation to OAHF.

3. ***Q: I am submitting my AFS for the year in which the M2M closing occurred. The REAC FASS system presents the non-M2M Surplus Cash template instead of the M2M Surplus Cash template. What should I do?***

Contact your HUD Project Manager and ask that they confirm that the Real Estate Management System (REMS) has been updated to reflect the project as a M2M project. After assuring that all of this is correct, if the problem continues, contact REAC's Technical Assistance Center at <http://www.hud.gov/offices/reac/contactus/fass-mfh.cfm> or by phone at (888-245-4860).

4. ***Q: For the partial year after closing the M2M restructuring, I elected to calculate Surplus Cash as of the M2M closing date, and to distribute that Surplus Cash in accordance with the pre-M2M cash distribution rules. How should I document this in the AFS?***

Include a footnote that documents your election. Include the Surplus Cash computation as of the M2M closing date, as part of the footnote.

Any positive Surplus Cash as of the M2M closing date should be reflected as an obligation on the Surplus Cash schedule as of fiscal year end (i.e., the post-M2M Surplus Cash schedule). The pre-M2M Surplus Cash (and any post-M2M Surplus Cash) can be distributed after the fiscal year end date. Also see the 2005 Letter, part 2 of question #5.

5. ***Q: I am the new owner of a project that previously went through a M2M debt restructure transaction. I am having trouble getting the REAC FASS system to accept the partial year AFS starting on the purchase date. What can I do to obtain assistance?***

First contact your local HUD office project manager and ask that they confirm that the Real Estate Management System (REMS) has been updated with your Tax Identification number, your date of acquisition ("FASS Date"), your fiscal year end date (such as December 31), and any other data that affect FASS. Also be sure that your "FASS Coordinator" has been properly registered with REAC. Applicable submission and registration rules are contained in the FASS Industry User Guide available at the REAC website at:

[http://www.hud.gov/offices/reac/products/fass/fassmf\\_guideChanges.cfm](http://www.hud.gov/offices/reac/products/fass/fassmf_guideChanges.cfm).

If your FASS submission is still not accepted, contact REAC's Technical Assistance Center at <http://www.hud.gov/offices/reac/contactus/fass-mfh.cfm> or by phone at (888-245-4860).

**6. Q: How should I reflect MRN/CRN payments in the Statement of Cash Flows?**

MRN/CRN payments must be segregated from all other debt payments, in the Statement of Cash Flows. The following FASS accounts should be used to reflect m2M debt:

- (MRN Principal Payments) S1200-361 Principal Payments - Second Mortgage
- (MRN Interest Payments) S1200-181 Interest Payments - Second Mortgage
- (CRN Principal Payments) S1200-362 Principal Payments - Third Mortgage
- (CRN Interest Payments) S1200-182 Interest Payments - Third Mortgage

If the MRN/CRN is in first lien position, please do **not** use the FASS accounts for first mortgage payments to reflect MRN/CRN payments. Rather, use the FASS accounts identified above (regardless of lien position).

If it is not possible to dedicate the above-mentioned FASS accounts solely for MRN/CRN payments, owners should use a reporting approach that separately identifies payments made toward the MRN/CRN (for example, detailing MRN/CRN payments in a footnote).

**7. Q: What are some common errors in post-M2M AFS?**

Common errors include:

- a. In the Statement of Cash Flows, not recording CRP payments correctly. The correct FASS accounts are:
  - S1200-417 Principal Payments on Capital Recovery Payment (M2M)
  - S1200-195 Interest on Capital Recovery Payment (M2M) (see 2005 Letter question #7)
- b. Showing the current year Incentive Performance Fee (IPF) as an obligation on the Surplus Cash schedule (see the 2004 Letter, question #7, for how to correctly reflect IPF).
- c. In the Statement of Cash Flows, not recording IPF payments correctly. The correct FASS account is S1200-223 Entity - Incentive Performance Fee.
- d. In the Statement of Cash Flows, not recording payment of the cash flow “split” from the prior year’s Surplus Cash correctly. The correct FASS account is S1200-420 Distributions for the owner portion of the split.

**8. Q: When can Surplus Cash be distributed, for a post-M2M property?**

For a property that completed a M2M debt restructure transaction, Surplus Cash cannot be distributed until after the AFS is filed. Also, Surplus Cash cannot be distributed until all other requirements have been satisfied (for example, the Incentive Performance Fee cannot be earned or paid unless certain preconditions have been satisfied, see 2004 Letter, question #2). That is, the December 31, 2005 Surplus Cash cannot be distributed until the spring of 2006 at the earliest. Mid-year distributions are not allowed for post-M2M projects.

9. ***Q: In the AFS, how do I reflect Capital Recovery Payment (CRP) installments that have become due but, as of the AFS date, have not been paid?***

Unpaid CRP installments will be reflected on the balance sheet as liabilities (the principal amount will be reflected as a result of recording the CRP loan at the time of the M2M closing, and the interest amount will be reflected because the interest will have accrued). Note, however, that no additional interest may be accrued because of the delay in payment.

If, as of the FYE date, the pre-conditions for payment of these CRP installments have been satisfied, reflect the unpaid installments as obligations on the Surplus Cash schedule. Otherwise, do not reflect the unpaid installments as obligations on the Surplus Cash schedule. Also see the 2005 Letter, question #7.

10. ***Q: I have not received any correspondence regarding my Surplus Cash computation or regarding payments on my M2M debt. Can I assume that HUD accepted my computations?***

No. Going forward, you will receive a demand letter from HUD if the annual M2M payment amount reflected in your project's annual financial statement has not been paid within 30 days of the filing date. That delinquent amount will also appear on your next monthly billing statement from HUD's servicer for these Notes, DynAccSys.

HUD's PCPM Contractor is currently performing in-depth analyses of AFSs for HUD for all years since M2M closing. The results of those analyses and any adjustments necessitated by their findings will be communicated to you in writing with a detailed explanation of HUD's analysis. That process requires input from the HUD PM and owners and thus is/has been very time intensive. All payments due, and all payments received to date, will be reconciled and reflected on your monthly billing statement (sent monthly to the project owner or managing agent by HUD's servicer for these Demo Notes, DynAccSys).

11. ***Q: Last year I received correspondence from the HUD PM for my project which stated that my response to their review findings of the Annual Financial Statements had been reviewed and the matter was now closed. I was recently contacted by HUD's PCPM Contractor with similar questions. Why must I respond to them? This is redundant.***

The two reviews focus on distinct aspects of the AFS, and are therefore not redundant in scope. You may receive correspondence regarding one or both reviews, and the controlling legal documents require your cooperation with both. The Surplus Cash analysis is specifically focused on protecting the value of the M2M portfolio. Either the HUD PM, or the PCPM (at the HUD PM's direction) may contact you regarding the analysis.

## 2006 M2M Accounting Q&As

Page 5 of 5

**For Additional Information.** This guidance is offered as a resource for post-M2M owners and their accountants. If you have other M2M accounting related questions, please review the 2004 and 2005 M2M accounting letters at OAHP's web site <http://www.hud.gov/offices/hsg/omhar/mhrowner.cfm>. You may submit deal specific or general questions to the OAHP Resource Desk at [resourcedeskweb@oahp.net](mailto:resourcedeskweb@oahp.net) or direct questions to Jo Anne Garrison, or Mike Murphy of my staff by telephone at (202)708-0001.

For more information on M2M, visit the OAHP website at <http://www.hud.gov/offices/hsg/omhar/>. For questions specific to the filing of financial statements via the FASS system, contact the REAC Technical Assistance Center (TAC) at 800-245-4860 or <http://www.hud.gov/offices/react/support/tac.cfm>.

Sincerely,



Theodore K. Toon  
Acting Deputy Assistant Secretary  
Office of Affordable Housing Preservation