



Common Challenges in FSS Escrow Accounting and How to Avoid Them

This document describes common challenges in FSS escrow accounting and strategies for avoiding or addressing them, including:

1. Accurately tracking households' escrow balances (p.1)
2. Allocating interest to participant households (p.3)
3. Submitting timely and accurate OARQ adjustments to HUD (p.3)
4. Accounting for FSS escrow accrual by tenants who fail to report their full income as required (p.4)

1. ACCURATELY TRACKING HOUSEHOLDS' ESCROW BALANCES

Challenge/Risk: Failure to update monthly escrow accrual in a timely manner on the escrow ledger, resulting in inaccurate monthly escrow credits and cumulative escrow amounts.

When doing internal account audits and reconciliations, some properties have found discrepancies between the cumulative amount of a family's FSS escrow credit as reflected on the property's FSS escrow account ledger (which details deposits, withdrawals, and interest for each family for the single FSS escrow account) and the amount they believe to be correct by retrospectively tabulating the family's FSS total escrow credit. This discrepancy can mean that the wrong escrow savings amounts are reported to participants, which can cause confusion and distrust and affect the participant's plans for using an interim or final escrow withdrawal to meet their goals. If there is a discrepancy, the property may also need to submit a retroactive OARQ adjustment with HUD to make the cumulative total of the OARQ adjustments for the FSS participant accurate and assure that the correct amount can be deposited into the FSS escrow account.

Why this happens: There are generally four sources of information on an FSS participant's escrow accumulation:

1. The property's FSS escrow account ledger that tracks escrow credits and disbursements for each participating household;
2. The OARQ adjustments included on the property's monthly HAP voucher;
3. Records of recertifications and corresponding escrow credit calculations; and
4. Records of communication between the property and FSS participants about their escrow accumulation and balances.

The escrow account ledger will generally be the most complete and should thus be the primary system of record, but it should be possible to reconcile all main sources¹, and is helpful to do so periodically.

¹ In reconciling these sources, note that the OARQ adjustments will not reflect disbursements of FSS escrow to participants or the allocation of interest to participants - items that need to be considered in computing a participant's escrow balance. The FSS coordinator may or may not be aware of how much interest has been allocated to each FSS participant.

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Discrepancies between these sources can arise for multiple reasons, including the fact that several different people are involved in the processes that affect escrow accumulation and accounting. For example, the staff member who conducts the recertification of income may not be the same as the staff member who manages the escrow account ledger or the staff member who handles billing and OARQ adjustments.

Properties need to put procedures in place to ensure that a new escrow calculation is conducted promptly after every recertification of a household participating in FSS and that the results of these calculations are reflected in the escrow ledger and OARQ adjustments in a timely manner. Procedures also need to be put into place to ensure that, if a recertification leads to a new escrow amount, but the voucher(s) had already been submitted for the applicable month(s), a retroactive OARQ adjustment is submitted to HUD the following month to correct the previously submitted OARQ adjustment(s).

Addressing this challenge: While errors are always possible, FSS programs are most likely to avoid inaccurate escrow ledgers by taking the following steps:

1. Put procedures in place to ensure that staff conducting recertifications know which tenants are in FSS and inform staff who handle billing (including OARQ adjustments) and escrow accounting when there is any change in earnings, including the effective date of the change in TTP so a new calculation can be made of the household's monthly FSS escrow credit, with corresponding adjustments to the escrow ledger and monthly OARQ adjustments;
2. Train all relevant staff on these procedures, their own roles and how the roles of each are related; refresher trainings may be needed periodically;
3. Assign a single individual with primary responsibility for managing the escrow processes—particularly recording monthly escrow credits and debits, and any retroactive adjustments needed to fix past errors—and have this individual included in all communications relating to changes in rent, billing, and escrow credit for FSS participants;
4. Conduct internal audits or reconciliations of the different sources of information on FSS escrow accruals frequently—at least quarterly (not just when families make interim or final withdrawals);
5. Only provide participants with reporting of cumulative escrow amounts up through the most recent month for which the program believes the reporting is accurate (i.e., if there is a lag of one month in reconciling changes in escrow, only provide information through the previous month).

If you find that there has been inaccurate escrow accounting, the next step is to do an audit or reconciliation of the affected household's escrow accounting, including a review of:

- Recertifications,
- Associated changes in escrow amounts,
- OARQ adjustments,
- Associated account deposits, and
- The FSS escrow ledger.

Once the correct total has been determined, notify the household as soon as possible of the error and of the updated escrow totals and/or monthly accruals to help the family plan and to preserve trust.

If this process gives the owner reason to suspect there may be additional or systemic errors in escrow ledger accounting, two additional actions are recommended:

1. An audit or reconciliation of all open FSS escrow accounts, and
2. A review of policies and procedures relating to FSS escrow determination and accounting.

2. ALLOCATING INTEREST TO PARTICIPATING HOUSEHOLDS

Challenge/Risk: Interest on the FSS escrow depository account is not properly credited in the escrow ledger.

FSS regulations require that monthly escrow credits be deposited into a single interest-bearing bank account for the property and that the account's interest be allocated to each family's ledger entries at least annually. The process of allocating interest to FSS participants can be confusing and easily missed. While the amounts of interest applied tend to be relatively small, it is important that FSS providers meet the requirement of applying this interest.

Why this happens: In allocating interest among participants, properties must follow the direction specified in Notice H-2016-08 that "The interest earned on funds in the FSS account will be credited to each family's FSS account based on the balance in each family's FSS account at the end of the period for which the interest is credited."

The allocation of FSS interest is a new and additional process. Furthermore, money is deposited into the FSS depository account on participants' behalf at different times, or may be withdrawn either for interim withdrawals to help participants meet goals or to adjust for accounting errors

Addressing this challenge: Properties should have procedures to regularly allocate interest to individual FSS participant households. The account manager should set a specific date, periodically (but at least annually) to apply the period's interest to all participants included in the FSS escrow ledger. In preparation for applying interest, the property should make sure that the escrow account ledger is up-to-date, and reflects all known credits, disbursements and adjustments (this confirmation or reconciliation may work best when led by a single individual in property management or accounting). Interest should be recorded as a separate entry for each family in the ledger each time it is applied so that the owner is able to report the interest to the family as part of their regular escrow savings statements.

3. SUBMITTING TIMELY AND ACCURATE OARQ ADJUSTMENTS TO HUD

Challenge/Risk: Properties do not keep up with OARQ adjustments or fail to change the monthly OARQ adjustment when the monthly escrow amount changes.

Multifamily owners bill HUD for deposits into the FSS depository account by including OARQ adjustments for each household accruing FSS escrow on the property's monthly HAP voucher. When monthly escrow credits change following a recertification of income, the change must be reflected not only on the escrow account ledger and corresponding deposits into the FSS escrow account, but also in the monthly OARQ adjustments.

In some cases, retroactive OARQ adjustments are needed – for example, if the OARQ adjustment for a household has already been submitted for a particular month, but the escrow deposit amount has changed for that household for that particular month, or if errors are discovered through the escrow reconciliation process described above (**see Challenge 1: Accurately Tracking Households' Escrow Balances**). Delays or errors in any of these steps can lead to errors in billing or accounting that must be corrected.

Why this happens: Most property management software does not currently have the capacity to automate the process of calculating FSS escrow and including OARQ adjustments on the HAP voucher. Properties will therefore need to enter the OARQ adjustments manually onto the voucher each month, or create a macro for this purpose. Either approach can introduce errors.

If there is no consistent process and policy to calculate changes in escrow and update existing OARQ adjustments as soon as a recertification is processed, an OARQ adjustment that is no longer accurate can remain in effect for multiple months, creating the need for an internal audit and multiple additional OARQ adjustments to fix the problem.

Furthermore, OARQ adjustments are submitted prospectively for the next month's HAP voucher. If there is a change to a family's TTP, earnings, and associated escrow credit that should be applied immediately, such as a reduction in TTP because of job and income loss, the property will usually have to submit a correction in the form of a "retroactive" OARQ adjustment. Retroactive adjustments are usually negative, because rent decreases can go into effect immediately, while rent increases require a 30-day notice to the tenant. If HUD has already paid the original OARQ adjustment for the predicted FSS credit and the owner has already deposited this amount into the escrow account and recorded it in the escrow ledger, the owner will have to:

1. correct the escrow amount in the account (which may mean a withdrawal from the account), and
2. make a correction in the escrow account ledger.

The number of staff and departments who are sometimes involved with different processes related to FSS escrow may make it harder to keep the multiple systems and processes coordinated, so clear, consistent, and traceable processes are important.

Addressing this Challenge: Owners should develop procedures to ensure that relevant staff are made aware of when changes are needed in monthly OARQ adjustments and when retroactive adjustments are needed. While errors are always possible, FSS programs are most likely to avoid errors and delays by implementing the five recommendations and procedures outlined in response to Challenge 1, above (*Accurately Tracking Households' Escrow Balances*).

If properties discover inconsistencies or delays, they should re-visit the process to understand what isn't working, refresh staff training, and audit all FSS-related accounting as soon as feasible.

4. FSS ESCROW ACCRUAL BY TENANTS WHO FAIL TO REPORT THEIR FULL INCOME AS REQUIRED

Challenge/Risk: Failures to report income complicate the calculation of and accounting for FSS escrow.

Why this happens: The FSS regulations make clear that if a household fails to report a portion of its income to the owner through a required interim or annual recertification, the household's FSS escrow shall be determined based on the amount of earned income reported and not on the higher actual amount (24 CFR § 984.305(a)(2)(iii)).

Addressing the problem: The accounting for this situation is somewhat complicated because the error in income reporting – once corrected – will result in a required repayment of back rent owed. However, the back rent, when paid, does not lead to a corresponding increase in escrow. The new higher FSS escrow accrual amount should begin once the resident starts paying the higher rent in months after discovery of the error. The effective date for the newly calculated FSS escrow amount will thus be different from the effective date for the amended income recertification.

Owners should develop procedures for handling this situation when it arises. Owners should also develop procedures for how they will handle late rent payments and partial rent payments by households in the FSS program.