

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
BEREA, KENTUCKY

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AUDITED FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT
FOR THE YEARS ENDED
JUNE 30, 2011 AND 2010



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

We have audited the accompanying statements of financial position of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization) as of June 30, 2011 and 2010, and the related statements of activities, changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Federation of Appalachian Housing Enterprises, Inc., as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 15, 2011 on our consideration of Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and important for assessing the results of our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of Federation of Appalachian Housing Enterprises, Inc. taken as a whole. The schedules of functional expenses on pages 22 and 23, the statements of financial position – Neighborworks America Capital Fund on page 24, and the statements of activities – Neighborworks America Capital Fund on page 25 are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal awards on page 16 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133 "Audits of States, Local Governments, and Non-Profit Organizations," and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.



Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
September 15, 2011

FEDERATION OF APPALACHIAN HOUSING, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2011

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Assets</u>				
Cash and cash equivalents	\$ 4,026,274	\$ 1,570,545	\$ 256,213	\$ 5,853,032
Accounts receivable	161,219	-	-	161,219
Accrued interest receivable	289,961	4,484	-	294,445
Investments	71,300	-	-	71,300
Deposits	2,820	-	-	2,820
Prepaid expenses	105,819	-	-	105,819
Property and equipment, net	800,908	-	-	800,908
Interfund balances	7,135	(7,135)	-	-
Mortgage notes receivable, net	12,530,499	9,239,107	67,421	21,837,027
Notes receivable, net	13,688,728	668,450	37,500	14,394,678
Property held for sale	1,100,508	446,609	-	1,547,117
Deferred compensation	21,002	-	-	21,002
	<u>32,806,173</u>	<u>11,922,060</u>	<u>361,134</u>	<u>45,089,367</u>
Total Assets	<u>\$ 32,806,173</u>	<u>\$ 11,922,060</u>	<u>\$ 361,134</u>	<u>\$ 45,089,367</u>
<u>Liabilities & Net Assets</u>				
<u>Liabilities</u>				
Accounts payable	\$ 100,133	\$ -	\$ -	\$ 100,133
Payroll taxes payable	22,768	-	-	22,768
Client advances and deposits	542,769	-	-	542,769
Accrued interest payable	49,597	4,375	-	53,972
Compensated absences payable	257,509	-	-	257,509
Deferred revenue	64,510	486,407	-	550,917
Notes payable	21,497,510	584,892	-	22,082,402
Deferred compensation	21,002	-	-	21,002
	<u>22,555,798</u>	<u>1,075,674</u>	<u>-</u>	<u>23,631,472</u>
Total Liabilities	<u>22,555,798</u>	<u>1,075,674</u>	<u>-</u>	<u>23,631,472</u>
<u>Other Liabilities</u>				
Equity equivalent	2,000,000	-	-	2,000,000
	<u>24,555,798</u>	<u>1,075,674</u>	<u>-</u>	<u>25,631,472</u>
Total Liabilities	<u>24,555,798</u>	<u>1,075,674</u>	<u>-</u>	<u>25,631,472</u>
<u>Net Assets</u>				
Net assets	7,650,375	10,846,386	361,134	18,857,895
Net assets, board designated	600,000	-	-	600,000
	<u>8,250,375</u>	<u>10,846,386</u>	<u>361,134</u>	<u>19,457,895</u>
Total Net Assets	<u>8,250,375</u>	<u>10,846,386</u>	<u>361,134</u>	<u>19,457,895</u>
	<u>\$ 32,806,173</u>	<u>\$ 11,922,060</u>	<u>\$ 361,134</u>	<u>\$ 45,089,367</u>
Total Liabilities & Net Assets	<u>\$ 32,806,173</u>	<u>\$ 11,922,060</u>	<u>\$ 361,134</u>	<u>\$ 45,089,367</u>

FEDERATION OF APPALACHIAN HOUSING, INC.
STATEMENT OF FINANCIAL POSITION
JUNE 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Assets</u>				
Cash and cash equivalents	\$ 5,246,225	\$ 1,278,615	\$ 149,148	\$ 6,673,988
Accounts receivable	784,675	(2,772)	-	781,903
Grants receivable	-	537,500	-	537,500
Accrued interest receivable	252,878	12,747	-	265,625
Deposits	3,120	-	-	3,120
Prepaid expenses	98,470	-	-	98,470
Property and equipment, net	860,177	-	-	860,177
Interfund balances	(4,173)	4,173	-	-
Mortgage notes receivable, net	10,861,643	9,726,093	69,175	20,656,911
Notes receivable, net	11,222,393	523,310	12,811	11,758,514
Property held for sale	1,002,665	224,068	-	1,226,733
Deferred compensation	15,513	-	-	15,513
	<u>\$ 30,343,586</u>	<u>\$ 12,303,734</u>	<u>\$ 231,134</u>	<u>\$ 42,878,454</u>
<u>Liabilities and Net Assets</u>				
<u>Liabilities</u>				
Accounts payable	\$ 102,963	\$ 53,735	\$ -	\$ 156,698
Payroll taxes payable	26,356	-	-	26,356
Client advances and deposits	645,337	-	-	645,337
Accrued interest payable	43,076	4,568	-	47,644
Compensated absences payable	207,844	-	-	207,844
Deferred revenue	4,510	428,520	-	433,030
Notes payable	19,591,799	610,806	-	20,202,605
Deferred compensation	15,513	-	-	15,513
	<u>20,637,398</u>	<u>1,097,629</u>	<u>-</u>	<u>21,735,027</u>
<u>Other Liabilities</u>				
Equity equivalent	<u>2,000,000</u>	<u>-</u>	<u>-</u>	<u>2,000,000</u>
	<u>22,637,398</u>	<u>1,097,629</u>	<u>-</u>	<u>23,735,027</u>
<u>Net Assets</u>				
Net assets	7,106,188	11,206,105	231,134	18,543,427
Net assets, board restricted	<u>600,000</u>	<u>-</u>	<u>-</u>	<u>600,000</u>
	<u>7,706,188</u>	<u>11,206,105</u>	<u>231,134</u>	<u>19,143,427</u>
Total Liabilities and Net Assets	<u>\$ 30,343,586</u>	<u>\$ 12,303,734</u>	<u>\$ 231,134</u>	<u>\$ 42,878,454</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENT OF ACTIVITIES
YEAR ENDING JUNE 30, 2011

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>Revenue</u>				
Mortgage and note interest	\$ 970,913	\$ 55,103	\$ -	\$ 1,026,016
Contributions, grants	15,660	135,000	-	150,660
State grants	105,000	-	-	105,000
Pass-through grants	1,184,323	24,000	-	1,208,323
Federal grants	985,000	-	130,000	1,115,000
Rental income	23,550	-	-	23,550
Investment income	142,244	6,540	-	148,784
Administration income	27,800	(8,160)	-	19,640
Gain on acquisition of assets	1,060,802	14,394	-	1,075,196
Fees and service charges	917,683	1,658	-	919,341
Miscellaneous income	4,820	-	-	4,820
Net assets released from restrictions				
Satisfaction of program restrictions	588,254	(588,254)	-	-
Total Revenue	<u>6,026,049</u>	<u>(359,719)</u>	<u>130,000</u>	<u>5,796,330</u>
<u>Expenses</u>				
Program services	3,106,388	-	-	3,106,388
General and administrative	1,690,241	-	-	1,690,241
Fundraising	264,957	-	-	264,957
Membership	420,276	-	-	420,276
Total Expenses	<u>5,481,862</u>	<u>-</u>	<u>-</u>	<u>5,481,862</u>
Increase(decrease) in net assets	544,187	(359,719)	130,000	314,468
Net Assets at Beginning of Period	<u>7,706,188</u>	<u>11,206,105</u>	<u>231,134</u>	<u>19,143,427</u>
Net Assets at End of Period	<u>\$ 8,250,375</u>	<u>\$ 10,846,386</u>	<u>\$ 361,134</u>	<u>\$ 19,457,895</u>

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

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENT OF ACTIVITIES
YEAR ENDING JUNE 30, 2010

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Revenue</u>				
Mortgage and note interest	\$ 783,420	\$ 67,211	\$ -	\$ 850,631
Contributions, grants	851,850	572,500	-	1,424,350
State grants	52,251	68,349	-	120,600
Pass-through grants	555,804	39,652	-	595,456
Federal grants	440,000	-	92,500	532,500
Rental income	2,700	400	-	3,100
Investment income	96,867	5,250	-	102,117
Administration income	52,130	10,000	-	62,130
Gain(Loss) on sale of property	293,144	-	-	293,144
Fees and service charges	1,005,920	1,732	-	1,007,652
Miscellaneous income	1,269	-	-	1,269
Net assets released from restrictions				
Satisfaction of program restrictions	328,252	(285,764)	(42,488)	-
Total Revenue	4,463,607	479,330	50,012	4,992,949
<u>Expenses</u>				
Program services	2,708,334	-	-	2,708,334
General and administrative	1,530,798	-	-	1,530,798
Fundraising	166,818	-	-	166,818
Membership	304,197	-	-	304,197
Total Expenses	4,710,147	-	-	4,710,147
Increase(decrease) in net assets	(246,540)	479,330	50,012	282,802
Extraordinary Gain	250,000	-	-	250,000
Net Assets at Beginning of Period	7,702,728	10,726,775	181,122	18,610,625
Net Assets End of Period	\$ 7,706,188	\$ 11,206,105	\$ 231,134	\$ 19,143,427

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

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDING JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Changes in Net Assets	\$ 314,468	\$ 532,802
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	86,212	71,737
(Gain)Loss on disposal of assets	70,870	92,964
(Increase)decrease in operating assets		
Accounts receivable	774,640	(524,072)
Grants receivable	537,500	1,562,500
Accrued interest receivable	(28,820)	(29,459)
Prepaid expenses	(7,349)	(37,003)
Deferred compensation	(5,489)	(10,763)
Deposits	300	150,000
Increase(decrease) in operating liabilities		
Accounts payable	(249,952)	119,436
Payroll taxes payable	(3,588)	4,101
Client advances and deposits	(31,400)	84,430
Accrued interest payable	6,328	(21,197)
Compensated absences payable	17,929	64,159
Deferred revenue	117,886	111,237
Deferred compensation	5,487	10,763
	<u>1,605,022</u>	<u>2,181,635</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(702,881)	(1,339,892)
Proceeds from sale of property and equipment	355,554	321,910
Payments received on notes receivable	14,269,031	(11,343,263)
Disbursement of loans receivable funds	(18,156,180)	11,750,163
	<u>(4,234,476)</u>	<u>(611,082)</u>
NET CASH USED BY INVESTING ACTIVITIES		
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt borrowings	5,053,741	4,977,034
Payments on long-term debt	(3,173,943)	(4,279,880)
	<u>1,879,798</u>	<u>697,154</u>
NET CASH PROVIDED BY FINANCING ACTIVITIES		
NET INCREASE IN CASH	(749,656)	2,267,707
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>6,673,988</u>	<u>4,406,281</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 5,924,332</u>	<u>\$ 6,673,988</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	<u>\$ 530,191</u>	<u>\$ 546,810</u>

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

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 1 – Organization

Federation of Appalachian Housing Enterprises, Inc. (FAHE or the Organization) is a non-profit, membership organization formed by a collaborative of non-profits in Central Appalachia in 1981. FAHE was created to provide a unified voice for the cause of eliminating sub-standard housing conditions that are so prevalent in the Central Appalachian region. FAHE currently has 47 members located throughout its service region of Kentucky, West Virginia, Virginia and Tennessee. Members include housing authorities, community housing developers, and community action agencies with a commitment to improving their local community by providing safe, decent and affordable housing options. FAHE's main office is located at 106 Pasco Street in Berea, Kentucky. In addition, FAHE has branch offices located in Maryville, Tennessee and Morehead, Kentucky.

FAHE achieves its mission by leveraging State and Federal monies with private resources to provide creative financing products to its members to promote community development; administering Federal and State housing programs to provide low-interest mortgages to individuals through its member network; maintaining revolving loan portfolios from both private and public sources to provide sustainable, affordable mortgage and commercial financing; creating innovative mortgage servicing standards to encourage and promote long-term homeowner success; providing access to pass-through grant and loan resources for members to assist them in achieving their individual missions; providing specialized services to members, such as mortgage servicing or mortgage loan processing and underwriting, to allow them to focus their resources on mission critical programs; working directly with local governments and private organizations to promote community economic development and increased capacity and availability of public infrastructure; and by providing networking opportunities through various state caucuses and semi-annual membership meetings to create a public forum for advocacy on behalf of its members and their causes in both the private and public sectors.

FAHE works through four significant venues to assist achieving its mission. The first of these is FAHE Capital Corporation I, which was formed in fiscal year 2000. FAHE Capital, a wholly-owned subsidiary limited liability company, was established to create, in partnership with other organizations, an equity fund to finance, develop and operate low-income housing tax credit (LIHTC) eligible development properties. Through the efforts of FAHE Capital and its partners, enough equity capital has been raised to develop several multi-million dollar LIHTC development projects throughout the state of Kentucky.

The second venue, a wholly-owned subsidiary limited liability company, FAHE Consulting, LLC, founded in fiscal year 2006 provides consulting services to municipalities and others through all stages of special projects development. In conjunction with FAHE and its members, FAHE Consulting assists with finding new projects, filing applications for funding or development approval, securing construction and permanent financing, facilitating and tracking construction progress and preparing any and all required project reports.

Third, FAHE developed a direct origination mortgage program in 2007. The program, JustChoice Lending, provides access directly for customers at the Berea and Maryville locations, and through FAHE members for the individuals and families they serve, to conventional lending mortgage products. By offering traditional conventional mortgage products with lower overall closing costs, and combining them with subsidies and homeowner counseling not normally available through traditional mortgage brokers, FAHE is able to provide a more divergent population with affordable, sustainable, quality mortgage financing.

Additionally, in fiscal year 2011 FAHE established FAHE TN, LLC. This entity domiciled in Tennessee provides for greater access to funds that would not normally be provided under the current organizational structure.

In fiscal year 2010 FAHE achieved a \$25 million set aside of USDA 502 funds, which also resulted in a national demonstration between USDA and nonprofits. In addition, a pipeline of \$15 million exists in NSP funds, \$15 million in TCAP and Exchange, and \$5 million in other ARRA projects. Also, in fiscal year 2011 FAHE

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 1 – Organization (Continued)

became a member of the Federal Home Loan Bank Cincinnati Division. This will allow access to additional resources for FAHE's membership.

Note 2 – Summary of Significant Accounting Policies

Principles of Combination

The financial statements include the combined statements of the Organization and its subsidiaries, FAHE Capital Corporation I, FAHE Consulting, LLC and FAHE TN, LLC. Accordingly, all significant inter-company balances and transactions have been eliminated.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual basis of accounting in accordance with generally accepted accounting principles. Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Organization and changes therein are classified and reported as follows:

- Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.
- Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met, either by actions of the Organization and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the Statement of Activities as net assets released from restriction.
- Permanently restricted net assets – Net assets subject to donor-imposed stipulations that they be maintained permanently by the Organization. Generally, the donors of these assets permit the Organization to use all or part of the income earned on any related investments for general or specific purposes.

Cash and Cash Equivalents

For purposes of the Statements of Financial Position and the Statements of Cash Flows, the Organization considers all highly liquid investments with an initial maturity of three months or less to be cash equivalents unless held by investment managers as part of the investment portfolio.

FAHE maintains an \$800,000 compensating balance arrangement with Wachovia/Wells Fargo Bank against a \$4.5 million line of credit.

Investments

The organization carries investments in equity securities with readily determinable fair values and all investments in debt securities at their fair values in the Statements of Financial Position. Unrealized gains and losses are included in the change in net assets in the accompanying Statements of Activities.

Mortgage Notes Receivable

Mortgage notes receivable are stated at the outstanding principal balance, less an allowance for loan losses. The allowance for loan losses is increased by charges to the change in net assets and decreased by charge-offs (net of recoveries). Interest income on the notes is recognized at the stated rate in the promissory note net of an interest allowance given to the borrower by the Organization based upon the need of the individual.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 2 – Summary of Significant Accounting Policies (Continued)

Since the interest rate charged to the borrowers corresponds with the customary rates applicable to the low-income housing industry, the Organization considers these rates to be reasonable and has not made any adjustment for imputed interest that would be applicable to higher interest rate conventional housing loans.

Allowance for Loan Losses

It is the policy of the Organization to provide valuation allowances for estimated loan losses. The allowance for loan losses represents management's best estimate of future bad debts. Additions to the allowance are charged to earnings. Accounts written off are charged against the allowance. Recoveries are credited to the allowance reserve.

Fixed Assets

The Organization capitalizes all expenditures for fixed asset acquisitions in excess of \$500. Fixed assets are carried at cost or, if donated, at the approximate fair value at the date of donation. Depreciation is computed on a straight-line basis over the useful lives of the assets generally as follows:

• Building and improvements	39	Years
• Computers and data handling equipment	3	Years
• Vehicles and equipment	5	Years
• Furniture and fixtures	5	Years

During the years ended June 30, 2011 and 2010, depreciation expense was \$81,191 and \$64,413, respectively. The increase in depreciation is primarily related to the purchase of new loan servicing software which was placed in service in May of 2010 with fiscal year 2011 reflecting the first full year of depreciation.

The Organization amortizes leasehold improvements over the shorter of the term of the lease or the economic life of the asset purchased. FAHE moved the Capital and Consulting operations from the Abney building to the Peoples Bank Building in June 2010. These improvements are being amortized over the term of the lease which is two years.

Amortization expense for the years ended June 30, 2011 and 2010 was \$5,021 and \$7,324, respectively.

Revenue Recognition

Contributions received are recorded as increases in unrestricted, temporarily restricted, or permanently restricted net assets, depending on the existence and/or nature of any donor imposed restrictions. All donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restriction. When a restriction expires (that is, when a stipulated time restriction ends or purpose restriction is satisfied), temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statements of activities as net assets released from restrictions.

Income Tax Status

The organization is recognized as a tax-exempt organization under code Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for federal income tax has been made. In addition, the Organization has been classified as an Organization that is not a private foundation under Section 509(a).

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 2 – Summary of Significant Accounting Policies (Continued)

The Organization is not aware of any unrelated business income as of September 15, 2011. In Accounting Standards Codification (ASC) 740-10-50, *Income Taxes*, (formerly FIN 48, *Accounting for Uncertainty in Income Taxes*) the Financial Accounting Standards Board (FASB) requires entities to disclose known or anticipated positions of income tax uncertainty. The Organization is not aware of any uncertain tax positions that would require adjustment to the financial statements. The Organization files income tax returns in the U.S. federal jurisdiction. Generally, the Organization is no longer subject to income tax examination by the U.S. federal, state or local tax authorities for years before 2008.

Compensated Absences

The Organization revised human resource policies regarding employee vacation and sick time beginning calendar year 2010. Previously upon separation of service employees could be paid up to a maximum of 80 accrued sick hours and 160 accrued vacation hours. As of January 1, 2010 employees will not receive pay for accrued sick time upon separation of service with the exception of sick hours earned and not spent as of December 31, 2009. However, accrued vacation time can now be paid out up to a maximum of 352 hours. The employee earns accrued time based on job classification, length of service and other factors. The liability accrued for compensated absences is limited to the actual amount that would be payable to the employee in the event of separation from employment. The amount is calculated based on multiplying the representative hourly wage by the number of accrued hours.

Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Functional Allocation of Expenses

The costs of providing various programs and other activities have been summarized on a functional basis in the statements of activities and detailed in the statements of functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

Note 3 – Investments and Fair Value Measurements

Investments held by the Organization consisted of the following as of June 30, 2011:

	<u>Cost</u>	<u>Market Value</u>	<u>Unrealized Appreciation</u>
FHLB stock	\$ 71,300	\$ 71,300	\$ -
Balance, June 30, 2011	<u>\$ 71,300</u>	<u>\$ 71,300</u>	-
Balance, June 30, 2010	<u>\$ -</u>	<u>\$ -</u>	-
Unrealized loss on investments			<u>\$ -</u>

The Organization has categorized its financial instruments, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. The hierarchy gives the highest priority to unadjusted quoted prices in an active market for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). If the inputs used to measure the financial instruments fall within different levels of

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
 NOTES TO FINANCIAL STATEMENTS
 JUNE 30, 2011 AND 2010

Note 3 – Investments and Fair Value Measurements (Continued)

the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. Financial assets and liabilities recorded on the statement of financial position are categorized based on the inputs to the valuation techniques as follows:

Level 1 – Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that the Organization has the ability to access.

Level 2 – Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable wither directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in non-active markets;
- pricing models whose inputs are observable for substantially the full term of the asset or liability; and
- pricing models whose inputs are derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the asset or liability.

Level 3 – Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement.

The Organization’s fair value of securities available for sale measured on a recurring basis at June 30, 2011 is as follows:

	<u>Fair Value Measurements at Reporting Date Using</u>			
	<u>Fair Value</u>	Quoted Prices in Active Markets for Identical Assets/Liabilities <u>(Level 1)</u>	Significant Other Observable Inputs <u>(Level 2)</u>	Significant Unobservable Inputs <u>(Level 3)</u>
FHLB Stock	<u>\$ 71,300</u>	<u>\$ -</u>	<u>\$ 71,300</u>	<u>\$ -</u>

Investments are included in the following items in the statement of financial position as of June 30, 2011:

Investments	<u>\$ 71,300</u>
-------------	------------------

Fair value for investments are determined by reference to quoted market prices and other relevant information generated by market transactions. There have been no changes in valuation techniques and related inputs.

Note 4 – Grant Funds Receivable

Unconditional promises to give amounted to \$537,000 as of June 30, 2010. Those funds were received in fiscal year 2011.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 5 – Property Held for Resale

Property held for resale consists of foreclosure properties (REO), properties owned by default, death or abandonment for which title has not yet passed (Conveyances) and land held for sale for future development by various members (Investment Property). Investment property is recorded at actual cost with an allowance made to reflect the lower of cost or market. REO property is recorded at the lower of cost or market when recovered from the foreclosure proceedings or by a deed-in-lieu of foreclosure. Conveyances are recorded at book value less an adjustment of 25% to allowance for loan loss. FAHE has adopted a conservative approach to the valuation of Conveyances lacking an appraisal. Gains or losses from the sale of properties are recorded in the statements of activities as either gains or losses on disposal of property. At June 30, 2011 and 2010, the organization held \$904,159 and \$740,639, respectively in REO property. At June 30, 2011, the organization held \$472,863 in conveyances. The organization held no conveyances at June 30, 2010. At June 30, 2011 and 2010, the organization held \$170,094 and \$486,094 respectively, in investment property.

Note 6 – Mortgage Notes Receivable

Loans are granted to low- and moderate-income residents of Central Appalachia for the purchase of new homes and the rehabilitation of existing homes. Mortgage lending funds are made available from several different sources. These sources include Federal and State grants awarded to the Organization, borrowings of lower interest funds made available by state housing agencies, grants from foundations, and revolved funds in the Organizations various lending portfolios. Loans are made in accordance with the restrictions imposed by the various funding sources.

At June 30, 2011 delinquencies were as follows: \$315,272 or 0.85% for 30-59 days; \$228,046 or 0.62% for 60-89 days; \$208,227 or 0.56% for loans 90+ days; \$133,227 or 0.36% for loans in foreclosure. Overall, loan delinquencies were \$751,545 or 2.03% on total loans of \$36,994,972 at June 30, 2011.

At June 30, 2010 delinquencies were as follows: \$250,643 or 0.76% for 30-59 days; \$167,495 or 0.51% for 60-89 days; \$370,446 or 1.11% for loans 90+ days; \$357,789 or 1.08% for loans in foreclosure. Overall, loan delinquencies were \$788,584 or 2.37% on total loans of \$33,246,514 at June 30, 2010.

Mortgage notes receivable as of June 30, 2011 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 3,745,053
AHTF Fund	401,374
HOME Program of Kentucky	7,122,471
Virginia Home Loan Fund	5,310,938
NHPR Kentucky	166,606
HOME Program of Virginia	2,210,661
West Virginia Home Loan Fund	1,266,622
Tennessee Home Loan Fund	1,054,437
Chase/NHSA	<u>962,823</u>
Total	22,240,985
Less: Allowance for Loan Losses	<u>(403,958)</u>
Mortgage Notes Receivable, Net of Allowance	<u><u>\$ 21,837,027</u></u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 6 – Mortgage Notes Receivable (Continued)

Mortgage notes receivable as of June 30, 2010 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 2,684,364
AHTF Fund	394,173
HOME Program of Kentucky	7,583,191
Virginia Home Loan Fund	5,547,664
NHPR Kentucky	211,644
HOME Program of Virginia	2,278,249
West Virginia Home Loan Fund	1,260,091
Tennessee Home Loan Fund	1,035,490
Neighborhood Stabilization Program	<u>114,100</u>
Total	21,108,966
Less: Allowance for Loan Losses	<u>(452,055)</u>
Mortgage Notes Receivable, Net of Allowance	<u><u>\$ 20,656,911</u></u>

The Organization has loan covenants with certain foundations that require the Organization to maintain certain levels of allowances to cover potential loan losses. In lieu of charging the full amount of the requirements to earnings, the Organization's Board of Directors has chosen to voluntarily designate a portion of its net assets for this purpose. The balance of the Board Designated Net Assets as of June 30, 2011, is \$600,000. This provides an aggregate loan loss coverage of 4.0% on the FAHE loan portfolio. Based on actual, historical delinquency trends, the Organization's management does not expect to incur any charges against this designation.

Note 7 – Notes Receivable

The Organization makes loans to promote community development, to provide additional resources for operations, and to facilitate housing construction and financing to other non-profits and local housing authorities throughout Central Appalachia. Combined borrower balances of the Organization's community loan portfolio as of June 30, 2011 and 2010 are presented below:

	<u>2011</u>	<u>2010</u>
Appalachia Habitat For Humanity	\$ 328,764	\$ 273,993
Appalachia Service Project	42,261	51,219
Beattyville Housing Development	306,843	384,438
Beattyville School	4,716	426,528
Blueberry Hill Estates	75,000	75,000
Cambria House	39,449	40,501
Clinch Valley Community	77,937	93,735
COAP	143,951	460,202
Community Housing Partners	1,999,034	2,802,242
Eastern Eight CDC	988,019	1,078,228
Frontier Housing, Inc.	1,371,079	1,302,984
Green Acres Development	60,783	64,000
Hazard/Perry County Community Ministries	27,525	29,782
Highland Community Builders, Inc.	36,346	-
Homeownership Center	44,935	112,250
HOMES, Inc.	1,009,241	1,084,810
HOPE Inc.	392,294	213,952

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 7 – Notes Receivable (Continued)

	<u>2011</u>	<u>2010</u>
Housing Authority of Mingo County	200,640	-
Housing Development Alliance	308,367	349,151
Housing Equity Fund of KY I	999,820	805,020
Housing Equity Fund of KY II	1,758,245	56,300
Housing Equity Fund of VA XII	776,837	-
Irvine Renaissance, LLP	270,418	285,300
KDVA Homes 07, LLP	1,309,322	264,658
Knox Housing Partners, Inc.	254,594	13,714
Kentucky Mountain Health Alliance	323,905	323,905
Kentucky Mountain Housing Corporation	487,513	492,763
Lil' Britches Child Care Center	64,275	67,283
Mountain Cap, Inc.	229,866	233,571
People Inc. Financial Services	99,896	99,900
Randolph County Housing Authority	436,996	295,847
Safe Housing & Economic Development	210,520	220,762
Southern Appalachian Labor School	90,988	95,164
Sterling Housing, Inc.	42,422	42,422
The Housing Partnership, Inc.	82,350	-
Virginia Community Development Fund	5,836	6,232
	<hr/>	<hr/>
Total Notes Receivable	14,900,987	12,145,856
Less: Allowance for Loan Loss	(506,309)	(387,342)
	<hr/>	<hr/>
Notes Receivable, Net of Allowance	<u>\$ 14,394,678</u>	<u>\$ 11,758,514</u>

Note 8 – Notes Payable

Notes payable at June 30, 2011 and 2010 consists of notes payable to governmental agencies, banks, non-profit organizations and individuals as detailed below.

	Rate	Term	Maturity	Balance	
				<u>2011</u>	<u>2010</u>
Kentucky Housing Corporation:					
Kentucky Home Loan Fund/AHTF					
Special Contract #2	1.00%	20 Years	January 1, 2012	\$ 9,500	\$ 19,000
Special Contract #3	1.00%	20 Years	February 1, 2013	27,800	41,700
Special Contract #4	1.00%	20 Years	July 1, 2013	61,500	82,000
Special Contract #5	1.00%	20 Years	July 1, 2014	82,000	102,500
Special Contract #6	1.00%	20 Years	July 1, 2015	103,750	124,500
Special Contract #7	1.00%	20 Years	July 1, 2016	126,019	147,022
Special Contract #8	3.00%	20 Years	October 1, 2035	443,851	455,755
Affordable Housing Trust Fund	1.00%	30 Years	July 1, 2033	52,313	54,327
Affordable Housing Trust Fund	1.00%	30 Years	September 1, 2035	3,973	5,783

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 8 – Notes Payable (Continued)

	Rate	Term	Maturity	2011	2010
Kentucky Housing Corporation:					
NHPL, NHRL, NHPR					
NHPL 1998-1999	1.00%	20 Years	July 1, 2018	-	262,307
NHPL 1999-2000	1.00%	20 Years	July 1, 2019	243,324	293,640
NHPR 2000-2001	1.00%	20 Years	July 1, 2020	316,125	347,738
NHPR 2001-2002	1.00%	20 Years	July 1, 2022	294,113	320,850
NHPR 2002-2003	1.00%	20 Years	July 1, 2023	403,551	437,114
NHPR 2003-2004	1.00%	20 Years	July 1, 2024	394,388	424,725
NHPR 2004-2005	1.00%	20 Years	July 1, 2025	324,450	347,625
NHPR 2005-2006	1.00%	20 Years	July 1, 2026	305,000	317,200
NHPR 2006-2007	1.00%	20 Years	November 1, 2027	139,200	147,900
NHPR 2007-2008	1.00%	20 Years	September 1, 2028	210,100	222,457
NHPR 2009	1.00%	20 Years	February 1, 2030	232,381	244,423
Virginia Housing Development Authority:					
Housing Fund #1	3.00%	30 Years	July 5, 2028	74,430	138,306
VHPRF Phase I & II	3.00%	20 Years	November 5, 2026	149,779	165,010
Housing Fund #2	3.00%	30 Years	December 5, 2018	238,625	246,336
Housing Fund #3	2.00%	30 Years	March 1, 2014	537,707	555,781
2004 Line of Credit	2.00%	30 Years	September 1, 2026	748,298	771,654
2005 Line of Credit	2.00%	30 Years	February 1, 2037	779,828	803,022
2007 Reach	3.00%	30 Years	April 1, 2038	663,048	679,064
2009 Reach	3.00%	30 Years	May 1, 2039	283,604	290,087
2010 Reach	3.00%	30 Years	July 1, 2040	527,589	312,610
Wachovia/Wells Fargo Bank					
Five Year Note	0.81%	5 Years	July 31, 2011	3,550,000	1,050,000
Various Lenders					
Sisters of Loretto	3.00%	3 Years	June 30, 2012	50,000	50,000
Richard Hettrick	3.00%	3 Years	January 31, 2013	5,500	5,500
Opportunity Finance Network	4.00%	5 Years	October 31, 2012	500,000	500,000
Andrew Schenker	3.00%	5 Years	June 1, 2013	25,000	25,000
Carter Garber	4.00%	5 Years	September 30, 2011	35,000	35,000
Franciscan Sisters of Mary	2.00%	5 Years	November 1, 2014	50,000	50,000
F. B. Heron Foundation	3.00%	6 Years	September 30, 2016	500,000	300,000
Tides Foundation	0.00%	5 Years	July 13, 2012	75,000	75,000
Ethel Ackley	3.00%	3 Years	July 13, 2010	-	5,000
Woodlands Investment Management	3.00%	4 Years	September 30, 2011	100,000	100,000
St. Paul's Church in Buffalo	3.00%	3 Years	August 31, 2012	5,000	5,000
Trust U/AGR D3/1/84, Fay Chandler	3.00%	3 Years	December 31, 2012	25,000	25,000
Trust U/AGR D3/1/84, Fay Chandler	3.00%	3 Years	March 21, 2013	50,000	50,000
Glenmary Home Missioners	2.00%	3 Years	September 30, 2013	25,000	25,000
Seton Enablement Fund	3.00%	5 Years	June 1, 2013	41,795	61,777
The Ford Foundation	1.00%	10 Years	June 2, 2014	1,000,000	1,000,000
Stookey Trust	3.00%	5 Years	September 30, 2010	-	25,000
U.S. Department of Agriculture	1.00%	30 Years	October 16, 2031	584,892	610,806
Cg of the Sisters of the Incarnate Word	2.00%	5 Years	August 24, 2011	200,000	200,000
Fannie Mae	1.13%	5 Years	May 7, 2012	2,000,000	2,000,000
Kentucky Housing Corporation	3.00%	23 Years	July 1, 2016	240,889	253,428
Peoples Self Help Housing	2.50%	2 Years	January 5, 2013	500,000	500,000
Dominican Sisters of Peace	3.00%	3 Years	July 1, 2012	20,000	20,000
CDFI Fund	1.25%	20 Years	September 10, 2019	930,000	930,000
Domestic Foreign Missionary Society	3.50%	5 Years	September 30, 2014	350,000	350,000
Calvert Social Investment Foundation	4.50%	3 Years	June 30, 2013	200,000	1,000,000
Opportunity Finance Network	3.00%	10 Years	November 30, 2019	2,500,000	2,500,000
Seton Enablement Fund	3.00%	5 Years	October 1, 2014	71,547	90,658
Mercy Investment Services	2.00%	5 Years	July 15, 2015	300,000	-
Episcopal, Diocese of Iowa	2.50%	3 Years	March 31, 2014	25,000	-
Stookey, Byron	3.00%	5 Years	September 30, 2015	25,000	-
Stookey, Lee	3.00%	5 Years	November 15, 2015	25,000	-
NHPR CLF Fund	1.00%	20 Years	December 1, 2030	296,533	-
Total Notes Payable				\$22,082,402	\$20,202,605

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 8 – Notes Payable (Continued)

The principal repayment requirements at June 30, 2011 and 2010 relating to the above notes payable are as follows:

	<u>2011</u>	<u>2010</u>
2011	\$ -	\$ 1,930,000
2012	5,944,500	2,404,000
2013	1,433,300	1,783,977
2014	1,691,002	1,637,781
2015	553,547	593,158
2016	453,750	-
Later Years	<u>12,006,303</u>	<u>11,853,689</u>
Totals	<u>\$ 22,082,402</u>	<u>\$ 20,202,605</u>

At June 30, 2011 and 2010 approximately \$12.029 million and \$5.998 million notes payable, respectively, are unsecured and represent private investments by individuals and groups.

At June 30, 2011 and 2010, respectively the Organization has a \$4.5 million line of credit with Wachovia/Wells Fargo Bank secured by \$4.8 million in commercial loan assets in 2011; a \$2.0 million line of credit with Fannie Mae backed by an unsecured letter of credit with Peoples Bank for \$450,000; a \$1.0 million line of credit with VHDA which is used to table fund loans and is immediately reimbursed; and a \$500,000 line of credit with Central Bank secured by real estate.

At June 30, 2011 the organization had available balances on lines of credit with Wachovia/Wells Fargo Bank of \$950,000, Central Bank of \$500,000, and capacity to drawn down another \$1.8 million on the Calvert Social Investment Foundation loan of \$2.0 million.

Note 9 - Other Liabilities

The Organization carries a \$2,000,000, ten year note with Wachovia/Wells Fargo Bank classified as EQ2 funds. This note is shown under Other Liabilities on the statements of financial position in order to represent more clearly the nature of the payable and to adhere to industry practice. The EQ2 is defined by having six attributes as follows (1) the EQ2 investment is carried as an investment on the investor's balance sheet in accordance with GAAP. (2) the EQ2 investment is a general obligation of FAHE that is not secured by any of FAHE's assets; (3) the EQ2 investment is fully subordinated to the right of repayment of all of FAHE's other creditors; (4) the EQ2 investment does not give the investor the right to accelerate payment unless FAHE ceases its normal operations; (5) the EQ2 investment carries an interest rate that is not tied to any income received by FAHE; and (6) the EQ2 investment has a rolling term, and therefore, an indeterminate maturity. This note had an outstanding balance of \$2,000,000 as of June 30, 2011 and 2010, respectively.

As of June 30, 2011, FAHE's unrestricted net assets to total assets ratio was 18.3%. If EQ2 funds are included as unrestricted net assets, then the modified ratio of unrestricted net assets to total assets is 22.7%.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2011 AND 2010

Note 10 – Commitments and Contingencies

The Organization receives Federal and State grant funds that are subject to review by the granting agencies. If an agency finds that the funds are considered not to have been used in accordance with the purposes of the grant, the grantor may request a refund of such funds. The amount of future potential refunds, if any, is not expected to be significant.

The Organization has an agreement with the Tennessee Housing Development Agency (THDA) to guarantee and service New Start loans to individuals, as well as guaranteeing and servicing member loan agreements with THDA. The Organization entered into the agreements to facilitate THDA working with the Organization's members located in Tennessee. Although management of the Organization feels these loans will be repaid and are fully secured by real estate, the Organization has a contingent liability of \$16,503,802 and \$15,128,774 as of June 30, 2011 and 2010, respectively. To further clarify, of the \$16,503,802 balance, FAHE is the first guarantor on the original \$1,481,598 and takes the position of second guarantor on the remaining member loan agreements.

Note 11 – Concentrations of Credit Risk

Financial instruments that potentially subject the Organization to a concentration of credit risk consist principally of cash and cash equivalents and notes receivable. The Organization maintains cash balances in various financial institutions. The cash accounts are primarily non-interest bearing and thus are fully insured by the Federal Deposit Insurance Corporation. Interest bearing accounts are insured up to \$250,000. The Organization manages the cash position to mitigate and or eliminate any associated risk. The Organization provides mortgage loans primarily to low- and moderate-income individuals. Mortgage notes totaling \$22,240,985 and \$21,108,966 at June 30, 2011 and 2010, respectively, are secured by the property purchased or improved except as noted. At June 30, 2011 notes totaling \$219,450 were deed restricted only. These mortgage receivables are a concentration of credit risk. The Organization provides loans to groups to support the growth of low-income housing opportunities in its service area. Notes receivable totaling \$14,900,987 and \$12,145,856 at June 30, 2011 and 2010, respectively, are secured by the assets of the Organization with the exception of the unsecured amount as noted. At June 30, 2011 and 2010, \$5,836 and \$922,363 respectively, were unsecured. Finally, the Organization receives a substantial percentage of its funding from government grants and other contributions. The Organization's management does not anticipate a reduction in such funding.

The Organization maintains a 4% loan loss reserve on the aggregate balance of the loan portfolio. These reserves may be found in the following balance sheet accounts: Mortgage Notes Receivable, Notes Receivable (netted against total loans) and Board Designated Net Assets. See notes 5 and 6 for additional information.

Note 12 – Subsequent Events

Management of the Organization has considered subsequent events through September 15, 2011, the date this report becomes available for issue.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Grantor's Number</u>	<u>Expenditures</u>
<u>Department of Treasury</u>			
NeighborWorks America	21.000		365,000
Community Development Financial Institutions	21.020	*	750,000
<u>Department of Housing & Urban Development</u>			
<u>Passed through Kentucky Housing Corporation</u>			
Home Investment Partnership Program (HOME)	14.239	HB09-0201-01	90,000
Home Investment Partnership Program (HOME)	14.239	HB10-0201-01	15,000
<u>Department of Housing & Urban Development</u>			
<u>Passed through Department for Local Government</u>			
Neighborhood Stabilization Program	14.228	09N-045	306,095
TOTAL FEDERAL AWARDS			<u><u>\$ 1,526,095</u></u>

* Major Program Circular A-133

See accompanying notes to Schedule of Expenditures of Federal Awards.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Federation of Appalachian Housing Enterprises, Inc. and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments and Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the financial statements.

NOTE B – INSURANCE

The Organization carried insurance coverage during the entire year in amounts sufficient to or in excess of required levels, including coverage for general and professional liability, real and personal property, workers compensation and fidelity bonding of employees who have access to funds.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

We have audited the financial statements of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization) as of and for the year ended June 30, 2011, and have issued our report thereon dated September 15, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Organization's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

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

This report is intended solely for the information and use of the Board of Directors, management, federal and state awarding agencies, and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.



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Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
September 15, 2011

REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO
EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER
COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Federation of Appalachian Housing Enterprises, Inc.
Berea, Kentucky

Compliance

We have audited Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization) with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the organization's major federal programs for the year ended June 30, 2011. Federation of Appalachian Housing Enterprises, Inc.'s major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Federation of Appalachian Housing Enterprises, Inc.'s management. Our responsibility is to express an opinion on Federation of Appalachian Housing Enterprises, Inc.'s compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Federation of Appalachian Housing Enterprises, Inc.'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Federation of Appalachian Housing Enterprises, Inc.'s compliance with those requirements.

In our opinion, Federation of Appalachian Housing Enterprises, Inc. complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

Internal Control Over Compliance

The management of Federation of Appalachian Housing Enterprises, Inc. is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the organization's internal control over compliance.



A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

This report is intended solely for the information and use of management, the Board of Directors, and federal and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Craft, Noble & Company, PLLC

Craft, Noble & Company, PLLC
September 15, 2011

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011

SUMMARY OF AUDITORS' RESULTS

1. The auditors' report expresses an unqualified opinion on the financial statements of Federation of Appalachian Housing Enterprises, Inc.
2. Our report on the financial statements disclosed no significant deficiencies in the internal control structure.
3. No instances of noncompliance material to the financial statements of Federation of Appalachian Housing Enterprises, Inc. were disclosed during our audit.
4. The auditors' report on compliance for the major federal awards program for Federation of Appalachian Housing Enterprises, Inc. expresses an unqualified opinion on all major federal programs.
5. Our audit report disclosed no audit finding required to be reported under Section 510(a) of OMB Circular A-133.
6. The programs tested as major programs included:

 NeighborWorks America CFDA #21.000 Type A.
 Neighborhood Stabilization Program CFDA #14.228 Type A.
7. The threshold to determine Type A: \$300,000.
8. Federation of Appalachian Housing Enterprises, Inc. was determined to be a low-risk auditee.
9. In connection with tests of internal control and compliance with laws and regulations, no material weaknesses were noted in internal control, and the Organization was in substantial compliance with laws and regulations.
10. There were no questioned costs with respect to major programs selected for compliance tests.

FEDERATION OF APPALACHIAN ENTERPRISES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2011

Expenses	Program Services										
	General & Administrative	Membership	Fundraising	Home Lending	Community Development	Grant Administration	Loan Servicing	FAHE Consulting	FAHE Capital	Total Program Services	Total
Personnel Expenses	\$ 647,327	\$ 160,957	\$ 101,473	\$ 297,421	\$ 87,477	\$ 87,477	\$ 297,421	\$ 209,944	\$ 209,944	\$ 1,189,684	\$ 2,099,441
Travel Expenses	28,004	6,963	4,391	12,867	3,784	3,784	12,867	9,082	9,082	51,466	90,824
Board & Committee Meetings	5,693	1,416	892	2,616	769	769	2,616	1,846	1,846	10,462	18,463
Conference & Workshops	6,227	1,548	976	2,861	842	842	2,861	2,020	2,020	11,446	20,197
Occupancy Expense	30,928	7,690	4,848	14,212	4,179	4,179	14,210	10,031	10,031	56,842	100,308
Supplies & Publications	5,316	1,322	833	2,442	718	718	2,443	1,724	1,724	9,769	17,240
Postage & Shipping	7,237	1,800	1,134	3,325	978	978	3,326	2,347	2,347	13,301	23,472
Communications	11,834	2,942	1,855	5,437	1,599	1,599	5,437	3,838	3,838	21,748	38,379
Equipment & Maintenance	19,141	4,759	3,000	8,794	2,587	2,587	8,794	6,208	6,208	35,178	62,078
Subscriptions	1,741	433	273	800	235	235	800	565	565	3,200	5,647
Licenses, Fees & Permits	1,310	326	205	602	177	177	602	425	425	2,408	4,249
Employee Education	1,477	367	232	679	200	200	679	479	479	2,716	4,792
Memberships	5,643	1,403	885	2,593	763	763	2,593	1,830	1,830	10,372	18,303
Marketing & Advertising	11,179	2,780	1,752	5,136	1,511	1,511	5,136	3,626	3,626	20,546	36,257
Liability & Property Insurance	21,275	5,290	3,335	9,775	2,875	2,875	9,775	6,900	6,900	39,100	69,000
Service Charges	2,181	542	342	1,002	295	295	1,002	707	707	4,008	7,073
Depreciation & Amortization	26,582	6,610	4,167	12,213	3,592	3,592	12,213	8,621	8,621	48,852	86,211
Organizational Expenses	286	71	45	131	39	39	131	93	93	526	928
Contributions	9,645	2,398	1,512	4,432	1,303	1,303	4,432	3,128	3,128	17,726	31,281
Software Lease	11,394	2,833	1,786	5,235	1,540	1,540	5,235	3,695	3,695	20,940	36,953
Professional Fees	38,245	9,510	5,995	17,572	5,168	5,168	17,572	12,404	12,404	70,288	124,038
Contract Services	65,714	16,340	10,301	30,193	8,880	8,880	30,193	21,313	21,313	120,772	213,127
Loan Processing Expense	737	183	115	338	100	100	338	239	239	1,354	2,389
Loan Servicing Expense	426	106	67	196	58	58	196	138	138	784	1,383
Pass Thru Grants	329,005	81,807	51,574	151,164	44,460	44,460	151,164	106,704	106,704	604,656	1,067,042
Over/Short	1,721	428	270	791	233	233	791	558	558	3,164	5,583
Administration	8,572	2,131	1,344	3,938	1,158	1,158	3,938	2,780	2,780	15,752	27,799
Bad Debt Expense	217,249	54,019	34,055	99,817	29,358	29,358	99,817	70,459	70,459	399,268	704,591
Interest Expense	165,427	41,133	25,932	76,007	22,355	22,355	76,007	53,652	53,652	304,028	536,520
Loans Forgiven	6,705	1,667	1,051	3,080	906	906	3,080	2,174	2,174	12,320	21,743
Miscellaneous Expense	2,020	502	317	928	273	273	928	655	655	3,712	6,551
Total Expenses	\$ 1,690,241	\$ 420,276	\$ 264,957	\$ 776,597	\$ 228,412	\$ 228,412	\$ 776,597	\$ 548,185	\$ 548,185	\$ 3,106,388	\$ 5,481,862

See Independent Auditors' Report.

FEDERATION OF APPALACHIAN ENTERPRISES, INC.
STATEMENT OF FUNCTIONAL EXPENSES
FOR THE YEAR ENDED JUNE 30, 2010

Expenses	Program Services										
	General & Administrative	Membership	Fundraising	Home Lending	Community Development	Grant Administration	Loan Servicing	FAHE Consulting	FAHE Capital	Total Program Services	Total
Personnel Expenses	\$ 654,437	\$ 130,048	\$ 71,317	\$ 369,170	\$ 192,975	\$ 25,171	\$ 302,048	\$ 125,853	\$ 142,633	\$ 1,157,850	\$ 2,013,652
Travel Expenses	33,346	6,626	3,634	18,810	9,833	1,283	15,390	6,413	7,268	58,997	102,603
Board & Committee Meetings	4,101	815	447	2,313	1,209	158	1,893	789	894	7,256	12,619
Conference & Workshops	5,484	1,090	598	3,093	1,617	211	2,531	1,055	1,195	9,702	16,874
Occupancy Expense	27,129	5,391	2,956	15,304	8,000	1,043	12,521	5,217	5,913	47,998	83,474
Supplies & Publications	8,830	1,755	962	4,981	2,604	340	4,075	1,698	1,924	15,622	27,169
Postage & Shipping	7,422	1,475	809	4,187	2,189	285	3,426	1,427	1,618	13,132	22,838
Communications	12,433	2,471	1,355	7,013	3,666	478	5,738	2,391	2,710	21,996	38,255
Equipment & Maintenance	18,623	3,701	2,029	10,505	5,491	716	8,595	3,581	4,059	32,947	57,300
Subscriptions	1,406	279	153	793	415	54	649	270	307	2,488	4,326
Licenses, Fees & Permits	1,449	288	158	817	427	56	669	279	316	2,564	4,459
Employee Education	2,609	518	284	1,472	769	100	1,204	502	569	4,616	8,027
Memberships	6,105	1,213	665	3,444	1,800	235	2,818	1,174	1,331	10,802	18,785
Marketing & Advertising	26,487	5,263	2,886	14,942	7,810	1,019	12,225	5,094	5,773	46,863	81,499
Liability & Property Insurance	16,760	3,331	1,826	9,454	4,942	645	7,735	3,223	3,653	29,652	51,569
Service Charges	4,730	940	515	2,668	1,395	182	2,183	910	1,031	8,369	14,554
Depreciation & Amortization	23,314	4,633	2,541	13,152	6,875	897	10,761	4,484	5,080	41,249	71,737
Organizational Expenses	437	87	48	247	129	17	202	84	95	774	1,346
Contributions	1,170	233	128	660	345	45	540	225	255	2,070	3,601
Software Lease	9,288	1,846	1,012	5,240	2,739	357	4,287	1,786	2,024	16,433	28,579
Professional Fees	22,853	4,541	2,490	12,891	6,739	879	10,548	4,395	4,981	40,433	70,317
Contract Services	77,257	15,352	8,419	43,581	22,781	2,971	35,657	14,857	16,838	136,685	237,713
Loan Processing Expense	593	118	65	335	175	23	274	114	129	1,050	1,826
Loan Servicing Expense	780	155	85	440	230	30	360	150	170	1,380	2,400
Pass Thru Grants	247,666	49,216	26,989	139,709	73,030	9,526	114,308	47,628	53,979	438,180	762,051
Over/Short	2,145	426	234	1,210	633	83	990	413	468	3,797	6,602
Administration	9,464	1,881	1,031	5,339	2,791	364	4,368	1,820	2,063	16,745	29,121
Bad Debt Expense	132,394	26,309	14,428	74,684	39,039	5,092	61,105	25,460	28,855	234,235	407,366
Interest Expense	170,824	33,946	18,615	96,362	50,371	6,570	78,842	32,851	37,231	302,227	525,612
Loans Forgiven	912	181	99	514	269	35	421	175	199	1,613	2,805
Miscellaneous Expense	350	69	40	196	101	12	159	66	75	609	1,068
Total Expenses	\$ 1,530,798	\$ 304,197	\$ 166,818	\$ 863,526	\$ 451,389	\$ 58,877	\$ 706,522	\$ 294,384	\$ 333,636	\$ 2,708,334	\$ 4,710,147

See Independent Auditors' Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
 STATEMENTS OF FINANCIAL POSITION - NEIGHBORWORKS AMERICA CAPITAL FUND
 JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
ASSETS		
Cash and cash equivalents	\$301,251	\$194,186
Mortgages receivable	<u>104,921</u>	<u>81,986</u>
 TOTAL ASSETS	 <u>\$ 406,172</u>	 <u>\$ 276,172</u>
NET ASSETS		
Temporarily restricted	\$45,038	\$45,038
Permanently restricted	<u>\$ 361,134</u>	<u>\$ 231,134</u>
 TOTAL NET ASSETS	 <u>\$ 406,172</u>	 <u>\$ 276,172</u>

See Independent Auditors' Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.
 STATEMENTS OF ACTIVITIES - NEIGHBORWORKS AMERICA CAPITAL FUND
 FOR THE YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
TEMPORARILY RESTRICTED NET ASSETS		
Restrictions released from permanently restricted net assets	\$ -	\$ 42,488
INCREASE IN TEMPORARILY RESTRICTED NET ASSETS	<u>-</u>	<u>42,488</u>
Revenues and Other Support		
Capital Grant-NeighborWorks America	130,000	92,500
Net assets released from restriction	<u>-</u>	<u>(42,488)</u>
INCREASE(DECREASE) IN PERMANENTLY RESTRICTED NET ASSETS	130,000	50,012
CHANGE IN NET ASSETS	130,000	70,138
NET ASSETS AT BEGINNING OF YEAR	<u>276,172</u>	<u>206,034</u>
NET ASSETS AT END OF YEAR	<u>\$ 406,172</u>	<u>\$ 276,172</u>

See Independent Auditors' Report.