

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
BEREA, KENTUCKY

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AUDITED FINANCIAL STATEMENTS AND  
INDEPENDENT AUDITOR'S REPORT  
FOR THE YEARS ENDED  
JUNE 30, 2013 AND 2012



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## INDEPENDENT AUDITOR'S REPORT

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

### **Report on the Financial Statements**

We have audited the accompanying combined financial statements of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization), which comprise the statements of financial position as of June 30, 2013 and 2012, and the related statements of activities and cash flows for the years then ended, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

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, 2013 and 2012, 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.

### ***Supplementary Information***

Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The schedules of functional expenses on pages 32 and 33, the statements of financial position – NeighborWorks America Capital Fund on page 34, the statements of activities –



NeighborWorks America Capital Fund on page 35 and the Computation of Adjusted Net Worth for Approval of Non-Supervised Mortgagees Other Than Loan Correspondents on page 36 are presented for purposes of additional analysis and are not a required part of the financial statements. The accompanying schedule of expenditures of federal awards on page 26, as required by Office of Management and Budget Circular A-133 *Audits of States, Local Governments, and Non-Profit Organizations* is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

#### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued a report dated September 16, 2013 on our consideration of Federation of Appalachian Housing Enterprises, Inc. internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting and compliance.

***Craft, Noble & Company, PLLC***

Craft, Noble & Company, PLLC  
Richmond, Kentucky  
September 16, 2013

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
STATEMENT OF FINANCIAL POSITION  
JUNE 30, 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>Assets</u>				
Cash and cash equivalents	\$ 8,843,719	\$ 1,486,658	\$ 818,318	\$ 11,148,695
Accounts receivable	532,666	3,960	-	536,626
Grants receivable	60,391	435,370	-	495,761
Accrued interest receivable	121,964	4,700	-	126,664
Investments	697,137	-	-	697,137
Deposits	2,862	-	-	2,862
Prepaid expenses	101,716	-	-	101,716
Property and equipment, net	934,904	-	-	934,904
Interfund balances	(232)	(4,315)	4,547	-
Mortgage notes receivable, net	14,316,463	9,480,608	157,294	23,954,365
Bankruptcy arrearages	10,317	3,206	-	13,523
Notes receivable, net	12,784,674	930,001	-	13,714,675
Property held for sale, net	497,974	258,792	19,841	776,607
Deferred compensation	50,175	-	-	50,175
Total Assets	<u>\$ 38,954,730</u>	<u>\$ 12,598,980</u>	<u>\$ 1,000,000</u>	<u>\$ 52,553,710</u>
<u>Liabilities &amp; Net Assets</u>				
<u>Liabilities</u>				
Accounts payable	\$ 143,004	\$ -	\$ -	\$ 143,004
Client advances and deposits	877,980	2,084	-	880,064
Accrued interest payable	85,212	3,766	-	88,978
Accrued expenses	214,408	-	-	214,408
Deferred revenue	1,232,955	664,994	-	1,897,949
Current portion of notes payable	1,152,421	26,510	-	1,178,931
Long-term portion of notes payable	21,915,890	506,320	-	22,422,210
Deferred compensation	50,175	-	-	50,175
Total Liabilities	<u>25,672,045</u>	<u>1,203,674</u>	<u>-</u>	<u>26,875,719</u>
<u>Other Liabilities</u>				
Equity equivalent	<u>4,000,000</u>	<u>-</u>	<u>-</u>	<u>4,000,000</u>
Total Liabilities	<u>29,672,045</u>	<u>1,203,674</u>	<u>-</u>	<u>30,875,719</u>
<u>Net Assets</u>				
Net assets	8,682,685	11,395,306	1,000,000	21,077,991
Net assets, board designated	600,000	-	-	600,000
Total Net Assets	<u>9,282,685</u>	<u>11,395,306</u>	<u>1,000,000</u>	<u>21,677,991</u>
Total Liabilities & Net Assets	<u>\$ 38,954,730</u>	<u>\$ 12,598,980</u>	<u>\$ 1,000,000</u>	<u>\$ 52,553,710</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
STATEMENT OF FINANCIAL POSITION  
JUNE 30, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Assets</u>				
Cash and cash equivalents	\$ 7,454,337	\$ 1,744,734	\$ 437,152	\$ 9,636,223
Accounts receivable	238,870	54,500	-	293,370
Grants receivable	-	1,159,501	-	1,159,501
Accrued interest receivable	234,551	4,525	-	239,076
Investments	75,700	-	-	75,700
Deposits	2,035	-	-	2,035
Prepaid expenses	109,124	-	-	109,124
Property and equipment, net	738,054	-	-	738,054
Interfund balances	50,555	(51,866)	1,311	-
Mortgage notes receivable, net	14,190,322	9,645,566	140,371	23,976,259
Bankruptcy arrearages	1,624	1,226	-	2,850
Notes receivable, net	12,594,266	718,552	-	13,312,818
Property held for sale, net	713,254	300,016	-	1,013,270
Deferred compensation	37,980	-	-	37,980
<b>Total Assets</b>	<b>\$ 36,440,672</b>	<b>\$ 13,576,754</b>	<b>\$ 578,834</b>	<b>\$ 50,596,260</b>
<u>Liabilities &amp; Net Assets</u>				
<u>Liabilities</u>				
Accounts payable	\$ 76,768	\$ 8,000	\$ -	\$ 84,768
Client advances and deposits	847,038	2,967	-	850,005
Accrued interest payable	69,455	4,196	-	73,651
Accrued expenses	269,394	-	-	269,394
Deferred revenue	1,228,127	656,058	-	1,884,185
Current portion of notes payable	1,947,317	-	-	1,947,317
Long-term portion of notes payable	19,704,408	558,951	-	20,263,359
Deferred compensation	37,980	-	-	37,980
<b>Total Liabilities</b>	<b>24,180,487</b>	<b>1,230,172</b>	<b>-</b>	<b>25,410,659</b>
<u>Other Liabilities</u>				
Equity equivalent	4,000,000	-	-	4,000,000
<b>Total Liabilities</b>	<b>28,180,487</b>	<b>1,230,172</b>	<b>-</b>	<b>29,410,659</b>
<u>Net Assets</u>				
Net assets	7,660,185	12,346,582	578,834	20,585,601
Net assets, board designated	600,000	-	-	600,000
<b>Total Net Assets</b>	<b>8,260,185</b>	<b>12,346,582</b>	<b>578,834</b>	<b>21,185,601</b>
<b>Total Liabilities &amp; Net Assets</b>	<b>\$ 36,440,672</b>	<b>\$ 13,576,754</b>	<b>\$ 578,834</b>	<b>\$ 50,596,260</b>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.

STATEMENT OF ACTIVITIES

YEAR ENDING JUNE 30, 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<u>Revenue</u>				
Mortgage and note interest	\$ 1,016,566	\$ 67,864	\$ -	\$ 1,084,430
Contributions, grants	49,269	198,741	-	248,010
State grants	779,114	281,313	-	1,060,427
Pass-through grants	844,484	31,000	-	875,484
Federal grants	571,000	127,500	500,000	1,198,500
Rental income	4,200	-	-	4,200
Investment income	521,575	531	-	522,106
Administration income	27,312	-	-	27,312
Gain on acquisition of assets	41,150	5,740	-	46,890
Fees and service charges	1,472,169	76	-	1,472,245
Miscellaneous income	2,004	-	-	2,004
Net assets released from restrictions				
Satisfaction of program restrictions	<u>1,742,875</u>	<u>(1,664,041)</u>	<u>(78,834)</u>	<u>-</u>
Total Revenue	<u>7,071,718</u>	<u>(951,276)</u>	<u>421,166</u>	<u>6,541,608</u>
<u>Expenses</u>				
Program services	1,604,234	-	-	1,604,234
General and administrative	3,712,719	-	-	3,712,719
Fundraising	432,565	-	-	432,565
Membership	299,700	-	-	299,700
Total Expenses	<u>6,049,218</u>	<u>-</u>	<u>-</u>	<u>6,049,218</u>
Increase (decrease) in net assets	1,022,500	(951,276)	421,166	492,390
Net Assets at Beginning of Period	<u>8,260,185</u>	<u>12,346,582</u>	<u>578,834</u>	<u>21,185,601</u>
Net Assets at End of Period	<u>\$ 9,282,685</u>	<u>\$ 11,395,306</u>	<u>\$ 1,000,000</u>	<u>\$ 21,677,991</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, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<u>Revenue</u>				
Mortgage and note interest	\$ 1,076,765	\$ 67,501	\$ -	\$ 1,144,266
Contributions, grants	357,476	1,911,929	-	2,269,405
State grants	178,094	375,313	-	553,407
Pass-through grants	538,616	227,500	-	766,116
Federal grants	535,385	100,740	282,000	918,125
Rental income	12,950	-	-	12,950
Investment income	1,083,039	2,452	-	1,085,491
Administration income	27,416	-	-	27,416
Gain on acquisition of assets	39,142	6,899	-	46,041
Fees and service charges	866,481	4,058	-	870,539
Miscellaneous income	1,707	-	-	1,707
Net assets released from restrictions				
Satisfaction of program restrictions	1,305,586	(1,241,286)	(64,300)	-
<b>Total Revenue</b>	<b>6,022,657</b>	<b>1,455,106</b>	<b>217,700</b>	<b>7,695,463</b>
<u>Expenses</u>				
Program services	1,464,532	-	-	1,464,532
General and administrative	3,977,237	-	-	3,977,237
Fundraising	163,804	-	-	163,804
Membership	407,274	-	-	407,274
<b>Total Expenses</b>	<b>6,012,847</b>	<b>-</b>	<b>-</b>	<b>6,012,847</b>
Increase in net assets	9,810	1,455,106	217,700	1,682,616
Net Assets at Beginning of Period	8,250,375	10,891,476	361,134	19,502,985
<b>Net Assets at End of Period</b>	<b>\$ 8,260,185</b>	<b>\$ 12,346,582</b>	<b>\$ 578,834</b>	<b>\$ 21,185,601</b>

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, 2013 AND 2012

CASH FLOWS FROM OPERATING ACTIVITIES	<u>2013</u>	<u>2012</u>
Changes in Net Assets	\$ 492,390	\$ 1,682,616
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	93,371	87,028
Loss on disposal of assets	276,165	352,972
Provision for loan losses	93,483	610,322
Gain on investments using equity method	(21,437)	-
(Increase) decrease in operating assets		
Accounts receivable	(243,256)	(132,151)
Grants receivable	663,740	(1,117,288)
Accrued interest receivable	112,412	55,370
Prepaid expenses	7,408	(3,305)
Deferred compensation	(12,195)	(16,978)
Deposits	(827)	785
Increase (decrease) in operating liabilities		
Accounts payable	58,236	(15,366)
Payroll taxes payable	-	(22,768)
Client advances and deposits	30,059	310,113
Accrued interest payable	15,327	19,679
Accrued expenses	(54,986)	11,885
Deferred revenue	13,764	222,621
Deferred compensation	12,195	16,978
	<u>1,535,849</u>	<u>2,062,513</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES		
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(291,131)	(31,024)
Proceeds from sale of property and equipment	910	329,594
Purchase of investments	(600,000)	(4,400)
Payments received on notes receivable	13,279,732	13,287,382
Disbursement of loans receivable funds	(13,803,353)	(13,989,147)
	<u>(1,413,842)</u>	<u>(407,595)</u>
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES		
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from long-term debt borrowings	6,927,969	5,598,774
Payments on long-term debt	(5,537,504)	(3,470,501)
	<u>1,390,465</u>	<u>2,128,273</u>
NET CASH PROVIDED BY FINANCING ACTIVITIES		
NET INCREASE IN CASH	1,512,472	3,783,191
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>9,636,223</u>	<u>5,853,032</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 11,148,695</u>	<u>\$ 9,636,223</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	<u>\$ 584,806</u>	<u>\$ 529,104</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 1 – Organization**

Federation of Appalachian Housing Enterprises, Inc. (FAHE or the Organization) is a non-profit organization that was founded in 1980 to serve Appalachia via a network of non-profits. FAHE's mission is to lead this network to sustainable growth and measurable impact through a collective voice, and provide access to capital to meet the housing and community development needs of the region. FAHE currently has over 53 members located throughout its core service region of Kentucky, West Virginia, Virginia, Alabama and Tennessee. Members include housing authorities, community development housing organizations, community action agencies, mental health agencies, and Habitat for Humanity affiliates, all who share a commitment to improving their local community by providing safe, decent and affordable housing options. FAHE works toward this mission by focusing financing, technical expertise, and advocacy on building economic opportunity and individual and community asset building. FAHE's office is located at 106 Pasco Street in Berea, Kentucky.

FAHE is designated a Community Development Financial Institution (CDFI) by US Treasury. As a CDFI FAHE offers two clusters of loan products, one for nonprofit corporations who serve low-income populations and the other for low-income populations directly for home purchase. Loans to Nonprofit Corporations - Financial products provided to members and partner Community Development Corporations (CDCs) include: 1) affordable housing development loans for single-family construction, 2) affordable housing development loans for multi-family construction, and 3) working capital loans or business loans. The target market end user of these loans is the low-income targeted population or low-income communities. Loans to Individual Borrowers - FAHE provides loans directly to borrowers for home purchase. FAHE is an approved FHA and USDA lender offering a combination of loans held on balance sheet, loans sold off balance sheet, loans packaged to USDA Rural Development and State Housing Finance Agencies. In addition to traditional mortgage products, FAHE provides subordinated loans to low-income homebuyers to ensure affordability. The subordinated finance can be in the form of an amortized loan or as a soft second for down payment assistance. FAHE services loans under third party contracts for companies who wish to outsource this highly specialized and technical activity.

FAHE Capital Corporation I, a wholly-owned subsidiary of FAHE, was formed in 2000 to syndicate private investments from corporations, generating a market rate return delivered through a federal tax credit. Investments raised through Low Income Housing Tax Credit Equity Funds managed by FAHE Capital Corporation I and a partner, Virginia Community Development Corporation, facilitated the creation/preservation of affordable rental housing.

FAHE Consulting, LLC, a wholly-owned subsidiary of FAHE, was formed in 2007 to help communities connect to opportunities by providing turn-key consulting services to nonprofits, municipalities, and others who wish to accomplish community development outcomes but who lack the technical expertise or personnel to achieve their desired outcomes. FAHE Consulting assists with filing applications for federal, state and local funding, oversees the development process, securing construction and permanent financing, facilitating and tracking construction progress and preparing any and all required project reports.

In 2011 FAHE established FAHE TN, LLC. This entity is domiciled in Tennessee and was created to provide access to investments through Tennessee's Community Investment Tax Credit Program.

FAHE facilitates networking opportunities to its members through state caucuses and semi-annual membership meetings to create a public forum for advocacy in both the private and public sectors. FAHE provides access to pass-through grants to members when funding is available.

In fiscal year 2013, FAHE directly invested \$66 million in the region and our members served over 6,400 families. Additionally, total capital under management, including loans serviced for other organizations, topped \$170 million. Since 1980 FAHE and its members have built or preserved more than 81,400 homes, and have made over \$406 million in direct investment for a total impact of \$851 million.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**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 on the original and/or revolving proceeds 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 Commercial Bank against a \$6 million line of credit.

Cash received from grants and held with temporary restrictions at June 30, 2013 and 2012 was \$1,486,658 and \$1,744,734, respectively. Cash permanently restricted for loans to clients at June 30, 2013 and 2012 was \$818,318 and \$437,152, respectively.

**Investments**

The organization carries investments in equity securities with readily determinable fair market values and all investments in debt securities at their fair values in the Statement of Financial Position. Unrealized gains and losses are included in the change in net assets in the accompanying Statement of Activities. The Organization holds two investments that are recorded using the equity method, due to no fair value or equivalent being readily determinable.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 2 – Summary of Significant Accounting Policies (Continued)**

**Mortgage Notes Receivable**

Mortgage and 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.

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, 2013 and 2012, depreciation expense was \$93,371 and \$82,007, respectively.

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 have been fully amortized over the shorter of the term of the lease of two years.

Amortization expense for the year ended June 30, 2013 and 2012 was \$0 and \$5,022, respectively.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 2 – Summary of Significant Accounting Policies (Continued)**

**Fixed Assets (Continued)**

A summary of property and equipment at June 30 is as follows:

	<u>2013</u>	<u>2012</u>
Land	\$ 39,248	\$ 35,000
Building	841,287	655,083
Building Improvements	28,556	28,556
Equipment and Vehicles	<u>535,383</u>	<u>442,496</u>
Subtotal	1,444,474	1,161,135
Accumulated Depreciation	<u>(509,570)</u>	<u>(423,081)</u>
Net Land and Depreciable Assets	<u>934,904</u>	<u>738,054</u>
Leasehold Improvements	28,295	28,295
Accumulated Amortization	<u>(28,295)</u>	<u>(28,295)</u>
Net Amortizable Assets	<u>-</u>	<u>-</u>
Total Net Property and Equipment	<u>\$ 934,904</u>	<u>\$ 738,054</u>

During the fiscal year ended June 30, 2013, the Organization began construction on a new office building. As of June 30, 2013 the current investment in the project was \$208,794 (\$4,248 included with land and \$204,546 included with building above). Depreciation on the building will begin when the asset is placed in use. The total estimated cost of completion for the project is \$2,600,000.

**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).

The Organization is not aware of any unrelated business income as of June 30, 2013. 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 2010.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
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**Note 2 – Summary of Significant Accounting Policies (Continued)**

**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 statement of activities and detailed in the statement 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, 2013:

	<u>Cost</u>	<u>Market Value</u>	<u>Unrealized Appreciation</u>
KYNWA Alliance investment	\$ 600,000	\$ 605,993	\$ 5,993
Scenic States investment	-	15,444	15,444
FHLB stock	<u>75,700</u>	<u>75,700</u>	-
Balance, June 30, 2013	<u>\$ 675,700</u>	<u>\$ 697,137</u>	21,437
Balance, June 30, 2012	<u>\$ 75,700</u>	<u>\$ 75,700</u>	-
Unrealized gain on investments			<u>\$ 21,437</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 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.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
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**Note 3 – Investments and Fair Value Measurements (Continued)**

*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 whether 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, 2013 and 2012 is as follows:

		<u>Fair Value Measurements at Reporting Date Using</u>		
		Quoted Prices in Active Markets for Identical Assets/Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>June 30, 2013</u>	<u>Fair Value</u>			
KY NWA Alliance investment	\$ 605,993	\$ -	\$ -	\$ 605,993
Scenic States investment	15,444	-	-	15,444
FHLB Stock	<u>75,700</u>	<u>-</u>	<u>75,700</u>	<u>-</u>
	<u>\$ 697,137</u>	<u>\$ -</u>	<u>\$ 75,700</u>	<u>\$ 621,437</u>
<u>June 30, 2012</u>				
FHLB Stock	<u>\$ 75,700</u>	<u>\$ -</u>	<u>\$ 75,700</u>	<u>\$ -</u>

Available-for-sale securities measured at fair value on a recurring basis using significant unobservable inputs (Level 3):

	<u>KYNWA Alliance</u>	<u>Scenic States</u>
July 1, 2011	\$ -	\$ -
Total gains and losses - unrealized		
Included in earnings	-	-
Included in other comprehensive income	<u>-</u>	<u>-</u>
June 30, 2012	<u>-</u>	<u>-</u>
Initial investment	600,000	-
Total gains and losses - unrealized		
Included in earnings	5,993	15,444
Included in other comprehensive income	<u>-</u>	<u>-</u>
June 30, 2013	<u>\$ 605,993</u>	<u>\$ 15,444</u>

Fair value for investments is 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.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
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**Note 4 – Grant Funds Receivable**

Unconditional promises to give amounted to \$495,761 and \$1,159,501 as of June 30, 2013 and 2012, respectively. These funds will be received in fiscal year 2014 and were received in fiscal year 2013, respectively.

**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 create an 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 statement of activities as either gains or losses on disposal of property.

Property held for resale also consists of property preservation advances. The Organization advances funds for expenses for property preservation to protect the value of their collateral related to mortgages receivable. These expenses are shown as receivables from the borrower unless the Organization takes the property back. At June 30, 2013 and 2012, the organization held \$645,018 and \$737,525, respectively in REO property, \$319,519 and \$263,500, respectively in conveyances, \$0 and \$170,094, respectively in investment property, and \$62,724 and \$53,258, respectively in property preservation. The related allowances recorded as of June 30, 2013 and 2012 were \$158,526 and \$145,232, respectively for REO property and \$92,128 and \$65,875, respectively for conveyances. There were no allowances recorded for investment property and property preservation advances.

**Note 6 – Mortgage Notes Receivable**

FAHE makes loans to individual borrowers for home purchase and rehabilitation of existing homes. FAHE is an approved FHA and USDA lender offering a combination of loans held on balance sheet, loans sold off balance sheet, and loans packaged to USDA Rural Development and State Housing Finance Agencies. In addition to traditional mortgage products, FAHE provides subordinated loans to low-income homebuyers to ensure affordability. The subordinated finance can be in the form of an amortized loan or as a soft second for down payment assistance. Mortgage lending funds are made available from several different sources. These sources include federal an62d 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 Organization’s various lending portfolios. Loans are made in accordance with the restrictions imposed by the various funding sources.

Mortgage notes receivable as of June 30, 2013 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 5,072,117
AHTF Fund	693,158
HOME Program of Kentucky	7,259,088
Virginia Home Loan Fund	5,095,817
NHPR Kentucky	86,647
HOME Program of Virginia	2,321,942
West Virginia Home Loan Fund	1,057,017
Tennessee Home Loan Fund	834,752
Chase/NHSA	719,678
FAHE Other States	1,405,471
Total	<u>24,545,687</u>
Less: Allowance for Loan Losses	<u>(591,322)</u>
Mortgage Notes Receivable, Net of Allowance	<u>\$ 23,954,365</u>



FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
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**Note 6 – Mortgage Notes Receivable (Continued)**

Mortgage notes receivable as of June 30, 2012 consist of the following balances in each fund:

Kentucky Home Loan Fund	\$ 5,178,704
AHTF Fund	544,470
HOME Program of Kentucky	7,429,628
Virginia Home Loan Fund	5,374,281
NHPR Kentucky	89,973
HOME Program of Virginia	2,329,457
West Virginia Home Loan Fund	1,129,635
Tennessee Home Loan Fund	887,263
Chase/NHSA	771,870
FAHE Other States	<u>798,726</u>
Total	24,534,007
Less: Allowance for Loan Losses	<u>(557,748)</u>
Mortgage Notes Receivable, Net of Allowance	<u><u>\$ 23,976,259</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, 2013, is \$600,000. This provides aggregate loan loss coverage of no less than 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 Corporations. Financial products provided to members and partner Community Development Corporations (CDCs) include: 1) affordable housing development loans for single-family construction, 2) affordable housing development loans for multi-family construction, and 3) working capital loans or business loans. The target market end user of these loans is the low-income targeted population or low-income communities. Combined borrower balances of the Organization's community loan portfolio as of June 30, 2013 and 2012 are presented on the following page:

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
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**Note 7 – Notes Receivable (Continued)**

	<u>2013</u>	<u>2012</u>
Appalachia Habitat For Humanity	\$ 340,250	\$ 318,295
Beattyville Housing Development	292,695	295,761
Burchwood Homes of Berea Ltd	41,040	43,200
Clinch Valley Community	46,913	62,735
COAP	100,093	96,774
Community Housing Partners	-	1,764,022
East Corbin School Apts, LLLP	1,666,928	-
Eastern Eight CDC	1,091,911	1,241,404
Frontier Housing, Inc.	754,126	796,391
Green Acres Dev	-	57,681
Hazard/Perry County Community Ministries	24,012	25,200
Highland Community Builders, Inc.	-	125,000
Homeownership Center	12,432	12,432
HOMES, Inc.	632,492	755,212
HOPE Inc.	370,920	11,713
Housing Authority of Mingo County	278,099	287,993
Housing Development Alliance	292,798	302,405
Housing Development Foundation, Inc.	414,906	-
Housing Equity Fund of KY I	-	970,327
Housing Equity Fund of KY II	2,425,712	2,399,712
Housing Equity Fund of KY III	865,919	-
Housing Equity Fund of VA XII	-	989,238
Irvine Renaissance, LLP	-	308,618
KDVA Homes 07, LLP	243,584	265,134
Knox Housing Partners, Inc.	89,831	92,259
Kentucky Highlands Investment Corp	-	69,857
Kentucky Mountain Housing Corporation	367,924	367,924
Lil Britches Child Care Center	57,690	61,081
Mountain Cap, Inc.	227,630	227,630
Mt. Sterling - Main Cross, LLC	869,692	-
Mulberry Housing LLP	45,000	45,000
Olde Town Housing, LLC	326,444	-
People Inc. Financial Services	102,918	99,885
Randolph County Housing Authority	424,755	489,369
Safe Housing & Economic Development	191,042	199,667
Scott-Morgan CDC	95,363	-
Southern Appalachian Labor School	82,673	87,289
St. Bartholomew Senior Apts	449,080	364,868
Sterling Housing, Inc.	53,442	42,422
The Housing Partnership, Inc.	891,675	185,000
Virginia Community Development Fund	-	315,552
Woodlands Development Group	45,000	30,152
	<hr/>	<hr/>
Total Notes Receivable	14,214,989	13,807,202
	<hr/>	<hr/>
Less: Allowance for Loan Loss	(500,314)	(494,384)
	<hr/>	<hr/>
Notes Receivable, Net of Allowance	\$ 13,714,675	\$ 13,312,818
	<hr/>	<hr/>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 8 – Allowance for Loan Losses**

FAHE has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in FAHE’s portfolio. For purposes of determining the allowance for loan losses, FAHE segments certain loans in its portfolio by product type. FAHE’s loans are segmented into the following segments: Community Loans or notes to corporations and Mortgages for single-family purchase and rehabilitation. These segments are then broken down into classes determined by length of delinquency. The Community Loans lending segment is also broken down into IRP and non-IRP classes because in order to be compliant, FAHE must maintain a loan loss reserve of at least 6% of the IRP fund, resulting in an additional loan loss calculation for that fund. The percentages have been determined based upon historical data for the Organization’s loan collections and delinquencies, and also to remain in compliance with related debt covenants. The loan loss set up for each length of delinquency is as follows:

Days Delinquent	Reserve Percentage
0-29 days	1%
30-59 days	2%
60-89 days	3%
90-179 days	5%
180+ days	25%

In addition, based on FAHE’s analysis of lending trends, FAHE has applied additional loss multipliers to the loan balances. Currently, FAHE has applied additional loss estimations to ensure that purchased loan portfolios are performing and that gains shown on those purchases are conservative. As the portfolio is cured, reserve is released either through writing off nonperforming loans or due to good performance of loans.

FAHE has also taken into account any properties conveyed back to the Organization via foreclosure or deed in lieu as an additional component of the allowance for loan losses. It is the Organization’s policy to immediately reserve 25% of the value of the note until a better estimate of property value can be acquired and the property can be written down to fair market value.

2013 Allowance for Loan Losses

	Mortgage Lending	Community Lending – IRP	Community Lending – Non-IRP	Total
Beg. Balance	\$ 557,748	\$ 36,736	\$ 457,648	\$ 1,052,132
Charge-Offs	(53,524)	-	(555)	(54,079)
Recoveries	100	-	-	100
Provision	<u>86,998</u>	<u>(6,186)</u>	<u>12,671</u>	<u>93,483</u>
Ending Balance	<u>\$ 591,322</u>	<u>\$ 30,550</u>	<u>\$ 469,764</u>	<u>\$ 1,091,636</u>

2012 Allowance for Loan Losses

	Mortgage Lending	Community Lending – IRP	Community Lending – Non-IRP	Total
Beg. Balance	\$ 403,958	\$ 42,667	\$ 463,642	\$ 910,267
Charge-Offs	(329,855)	-	(142,349)	(472,204)
Recoveries	3,747	-	-	3,747
Provision	<u>479,898</u>	<u>(5,931)</u>	<u>136,355</u>	<u>610,322</u>
Ending Balance	<u>\$ 557,748</u>	<u>\$ 36,736</u>	<u>\$ 457,648</u>	<u>\$ 1,052,132</u>

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 8 – Allowance for Loan Losses (Continued)**

***Credit Quality Information***

FAHE determines credit quality of its existing portfolio by examining delinquency monthly. The following tables present performing and nonperforming real estate loans based on payment activity for the years ended June 30, 2013 and 2012. Payment activity is reviewed by management on a monthly basis to determine credit quality of the loans. Loans are considered to be nonperforming when days delinquent is greater than 30 days in the previous month. The Organization has found that it is in its best interest to consider loans past this date nonperforming instead of the traditional single-family mortgage standard of 90 days. FAHE's Loan Servicing Department has found it has the best chances of collection if contact is made with the borrower during the first month of delinquency.

Nonperforming loans also include certain loans that have been modified in troubled debt restructurings where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from FAHE's loss mitigation activities and could include loan modification by way of reductions in the interest rate, payment extensions, forgiveness of principal, forbearance or other actions. Certain troubled debt restructurings are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months. Management believes the likelihood of loss for nonperforming loans is increased in this current period due to the persisting weak economy and the growth of performing loans transferred to nonperforming status upon modification in a troubled debt restructuring. The Organization also classifies its non-accrual loans as nonperforming.

	Performing vs. Nonperforming Loans					
	<u>Mortgage Lending</u>		<u>Community Lending IRP</u>		<u>Community Lending</u>	
	2013	2012	2013	2012	2013	2012
Performing	\$ 23,442,364	\$ 24,033,673	\$ 509,164	\$ 612,273	\$ 13,478,195	\$ 12,716,983
TDR	196,601	39,293	-	-	-	-
Non-accrual	-	-	-	-	227,630	-
Nonperforming	906,722	461,041	-	-	-	477,946
Total	<u>\$ 24,545,687</u>	<u>\$ 24,534,007</u>	<u>\$ 509,164</u>	<u>\$ 612,273</u>	<u>\$ 13,705,825</u>	<u>\$ 13,194,929</u>

***Age Analysis of Past Due Financing Receivables by Class***

The table on the following page includes an aging analysis of the recorded investment of past due financing receivables as of June 30, 2013 and 2012. Also included are loans that are 90 days or more past due as to interest and principal and still accruing, because they are (a) well-secured and in the process of collection or (b) real estate loans or loans exempt under regulatory rules from being classified as nonaccrual.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
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**Note 8 - Allowance for Loan Losses (Continued)**

Age Analysis of Past Due Financing Receivables by Class						
	30-59 Days Past Due	60-89 Days Past Due	90+ Days Past Due	Total Past Due	Current	Total Financing Receivables
<b>2013</b>						
Mortgage Lending	\$ 517,645	\$ 142,749	\$ 246,328	\$ 906,722	\$23,638,965	\$24,545,687
Community - IRP	-	-	-	-	509,164	509,164
Community - Non-IRP	-	-	-	-	13,705,825	13,705,825
Total	<u>\$ 517,645</u>	<u>\$ 142,749</u>	<u>\$ 246,328</u>	<u>\$ 906,722</u>	<u>\$37,853,954</u>	<u>\$38,760,676</u>
<b>2012</b>						
Mortgage Lending	\$ 167,818	\$ 157,847	\$ 135,376	\$ 461,041	\$24,072,966	\$24,534,007
Community - IRP	-	-	-	-	612,273	612,273
Community - Non-IRP	414,134	-	63,812	477,946	12,716,983	13,194,929
Total	<u>\$ 581,952</u>	<u>\$ 157,847</u>	<u>\$ 199,188</u>	<u>\$ 938,987</u>	<u>\$37,402,222</u>	<u>\$38,341,209</u>

***Impaired Loans***

FAHE considers a loan to be impaired when, based on current information and events, FAHE determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases FAHE uses the current fair value of the collateral, less selling costs when foreclosure is probable, instead of the discounted cash flows. If FAHE determines that the value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortized premium or discount), FAHE recognizes impairment through an allowance estimate or a charge-off to the allowance. FAHE determines impairment based on a 60-day default period for mortgages and makes a credit decision for community loans. Loans classified as troubled debt restructurings are also considered impaired.

When the ultimate collectability of the total principal of an impaired loan is in doubt and the loan is on nonaccrual status, all payments are applied to the principal, under the cost recovery method. When the ultimate collectability of the total principal of any impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

The table on the following page includes the recorded investment and unpaid principal balances for impaired financing receivables with the associated allowance amount, if applicable. FAHE determined the specific allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific allowance recorded.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
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**Note 8 - Allowance for Loan Losses (Continued)**

Impaired Loans			
	Unpaid Principal Balance	Related Allowance	Net Recorded Investment
2013			
Mortgage Lending	\$ 389,077	\$ (22,182)	\$ 366,895
Community – IRP	-	-	-
Community – Non IRP	227,630	(2,276)	225,354
Total	\$ 616,707	\$ (24,458)	\$ 592,249
2012			
Mortgage Lending	\$ 293,223	\$ (38,473)	\$ 254,750
Community – IRP	-	-	-
Community – Non IRP	530,470	(20,721)	509,749
Total	\$ 823,693	\$ (59,194)	\$ 764,499

***Nonaccrual loans***

In the Community Lending fund, FAHE generally places a loan on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, during which period staff work out a mitigation strategy with the borrower, and no restructuring has occurred. In the Mortgage Lending segment, loans at 0% interest are not considered nonaccrual because they were underwritten or designed with that intent and funded from a grant resource. Loans on nonaccrual status and their respective classes are as follows:

Nonaccrual Loans		
	2013	2012
Mortgage Lending	\$ -	\$ -
Community Lending - IRP	-	-
Community Lending - Non IRP	227,630	498,047
Total	\$ 227,630	\$ 498,047

When FAHE places a loan on nonaccrual status, FAHE reverses the accrued unpaid interest receivable against interest income and accounts for the loan on the cash or cost recovery method, until it qualifies to return to accrual status. Generally, FAHE returns a loan to accrual status when (a) all delinquent interest and principal become current under the terms of the loan agreement or (b) the loan is both well-secured and in the process of collection and collectability is no longer doubtful.

FAHE has determined that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date on the member's statement. Interest and fees continue to accrue on past due loans until the date the loan goes into nonaccrual status, if applicable.

**Note 9 – Notes Payable**

Notes payable at June 30, 2013 and 2012 consists of notes payable to governmental agencies, banks, non-profit organizations and individuals as detailed on the following page:

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 9 – Notes Payable (Continued)**

	Rate	Term	Maturity	Balance	
				<u>2013</u>	<u>2012</u>
Kentucky Housing Corporation					
Kentucky Home Loan Fund/AHTF					
Special Contract #3	1.00%	20 Years	February 1, 2013	\$ -	\$ 13,900
Special Contract #4	1.00%	20 Years	July 1, 2013	20,500	41,000
Special Contract #5	1.00%	20 Years	July 1, 2014	41,000	61,500
Special Contract #6	1.00%	20 Years	July 1, 2015	62,250	83,000
Special Contract #7	1.00%	20 Years	July 1, 2016	84,012	105,016
Special Contract #8	3.00%	20 Years	October 1, 2035	418,963	431,591
Affordable Housing Trust Fund	1.00%	30 Years	July 1, 2033	48,224	50,279
Affordable Housing Trust Fund	1.00%	30 Years	September 1, 2035	-	2,178
NHPL, NHRL, NHPR					
NHPL 1999-2000	1.00%	20 Years	July 1, 2019	184,596	213,960
NHPR 2000-2001	1.00%	20 Years	July 1, 2020	252,900	284,513
NHPR 2001-2002	1.00%	20 Years	July 1, 2022	240,638	267,375
NHPR 2002-2003	1.00%	20 Years	July 1, 2023	336,426	369,989
NHPR 2003-2004	1.00%	20 Years	July 1, 2024	333,713	364,050
NHPR 2004-2005	1.00%	20 Years	July 1, 2025	278,100	301,275
NHPR 2005-2006	1.00%	20 Years	July 1, 2026	273,280	292,800
NHPR 2006-2007	1.00%	20 Years	November 1, 2027	121,800	130,500
NHPR 2007-2008	1.00%	20 Years	September 1, 2028	185,383	197,742
NHPR 2009	1.00%	20 Years	February 1, 2030	207,934	220,249
Virginia Housing Development Authority					
Housing Fund #1	3.00%	30 Years	July 5, 2028	18,738	35,867
VHPRF Phase I & II	3.00%	20 Years	November 5, 2026	126,847	137,095
Housing Fund #2	3.00%	30 Years	December 5, 2018	222,491	230,679
Housing Fund #3	2.00%	30 Years	March 1, 2014	465,565	483,033
2004 Line of Credit	2.00%	30 Years	September 1, 2026	639,783	724,470
2005 Line of Credit	2.00%	30 Years	February 1, 2037	732,026	756,166
2007 Reach	3.00%	30 Years	April 1, 2038	428,495	592,608
2009 Reach	3.00%	30 Years	May 1, 2039	170,001	276,923
2010 Reach	3.00%	30 Years	July 1, 2040	503,722	515,835
2011 Reach	3.00%	30 Years	June 1, 2042	437,363	331,152
2012 Reach	3.00%	30 Years	June 1, 2043	114,927	-
Commercial Bank					
Ten Year Note - FAHE TN, LLC	3.25%	10 Years	April 10, 2023	500,000	-
Two Year Note	2.75%	2 Years	December 28, 2014	4,603,331	-
Various Lenders					
Wells Fargo Bank	2.85%	3 Years	April 1, 2015	-	3,550,000
PNC Bank National Association	2.20%	4 Years	June 1, 2017	790,000	-
Sisters of Loretto	1.00%	3 Years	June 30, 2015	33,500	50,000
Richard Hettrick	3.00%	3 Years	January 31, 2013	-	5,500
Opportunity Finance Network	4.00%	5 Years	October 31, 2012	-	500,000
Andrew Schenker	3.00%	5 Years	June 1, 2013	-	25,000
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	500,000
Tides Foundation	0.00%	5 Years	July 13, 2012	-	75,000
Woodlands Investment Management	3.00%	4 Years	September 30, 2015	100,000	100,000

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 9 – Notes Payable (Continued)**

Various Lenders (Continued)	Rate	Term	Maturity	Balance	
				<u>2013</u>	<u>2012</u>
St. Paul's Church in Buffalo	3.00%	3 Years	August 31, 2012	-	5,000
Trust U/AGR D3/1/84, Fay Chandler	3.00%	3 Years	December 31, 2012	-	25,000
Trust U/AGR D3/1/84, Fay Chandler	3.00%	3 Years	March 31, 2013	-	50,000
Glenmary Home Missioners	3.00%	3 Years	September 30, 2013	25,000	25,000
Seton Enablement Fund	3.00%	5 Years	June 1, 2013	-	21,208
The Ford Foundation	1.00%	10 Years	June 2, 2014	333,334	666,667
U.S. Department of Agriculture	1.00%	30 Years	October 16, 2031	532,830	558,951
Cg of the Sisters of the Incarnate World	2.00%	5 Years	November 17, 2016	250,000	250,000
Kentucky Housing Corporation	3.00%	23 Years	July 1, 2016	214,658	227,970
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
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	200,000
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	31,579	51,860
Mercy Investment Services	2.00%	5 Years	July 15, 2015	300,000	300,000
Episcopal, Diocese of Iowa	2.50%	3 Years	March 31, 2014	25,000	25,000
Byron Stookey	3.00%	5 Years	September 30, 2015	25,000	25,000
Lee Stookey	3.00%	5 Years	November 15, 2015	25,000	25,000
NHPR CLF Fund	1.00%	20 Years	November 1, 2031	305,732	320,775
US Department of Treasury – SBLF	2.00%	8 Years	September 15, 2019	2,063,000	2,063,000
Mutt Logic	1.00%	1 Year	August 15, 2013	1,000	-
Mary Reynolds Babcock Foundation	2.50%	6 Years	August 1, 2017	500,000	500,000
Emma C. Trevor	1.00%	3 Years	December 31, 2015	2,500	-
Eric Haralson	1.00%	2 Years	March 31, 2015	10,000	-
Jones Family Farm	1.00%	1 Year	May 30, 2014	25,000	-
Jones Family Farm	1.00%	2 Years	May 30, 2015	25,000	-
Kentucky NWA Alliance, LLC	2.00%	2 Years	October 1, 2015	600,000	-
Perls Foundation	1.00%	1 Year	January 1, 2014	100,000	-
Phyllis J. Hatfield	1.00%	1 Year	January 1, 2014	50,000	-
Sisters of Charity of the Blessed Virgin	1.00%	3 Years	November 18, 2014	100,000	150,000
Nazareth Literary & Benevolent Institution	1.00%	3 Years	December 30, 2014	50,000	50,000
<b>Total Notes Payable</b>				<u>\$ 23,601,141</u>	<u>\$ 22,210,676</u>

The principal repayment requirements at June 30, 2013 and 2012, relating to the above notes payable are as follows:

	<u>2013</u>	<u>2012</u>
2013	\$ -	1,947,317
2014	1,178,931	993,772
2015	6,232,907	4,634,602
2016	1,678,241	1,091,050
2017	1,362,197	1,373,817
2018	1,662,125	-
Later Years	11,486,740	12,170,118
	<u>\$ 23,601,141</u>	<u>\$ 22,210,676</u>



FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 9 – Notes Payable (Continued)**

At June 30, 2013 and 2012 approximately \$18 million and \$22 million notes payable, respectively, are unsecured and represent private investments by individuals and groups.

At June 30, 2012, the Organization had a \$6.00 million unsecured line of credit with Wells Fargo Bank (formerly Wachovia Bank). This loan was paid off during fiscal year 2013. The Organization replaced this line of credit with a new credit facility with Commercial Bank. This line of credit is secured by pledged notes receivable. At June 30, 2013 the balance of the line was \$4,603,331. FAHE closed a line of credit with PNC Bank in fiscal year 2012. The balance of this line of credit at June 30, 2013 was \$790,000. The Organization had a \$1.00 million line of credit with VHDA at the end of fiscal year 2011, which was used to table fund loans and then immediately reimbursed. This line of credit expired at June 30, 2012, but was renewed August 9, 2012 for the same amount and term as the previous line of credit. The Organization also had a \$500,000 unsecured, undrawn line of credit with Central Bank at both June 30, 2013 and 2012.

At June 30, 2013 the organization had available balances on lines of credit with Commercial Bank of \$1.40 million, PNC Bank of \$2.21 million and Central Bank of \$500,000.

**Note 10 - Other Liabilities**

The Organization carries a \$2.00 million, ten-year note with Wachovia 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 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 (also known as an evergreen provision). This note had an outstanding balance of \$2.00 million as of June 30, 2013 and 2012, respectively.

In fiscal year 2012, the Organization received another EQ2 investment from Pinnacle Bank. This is a ten year note, that beginning on the seventh anniversary of the maturity date and on each anniversary thereafter, unless the Organization ceases to be financially sound or ceases to carry out a community development mission, the maturity date is automatically extended by one year. This investment is to be used for single family housing in Knoxville, Tennessee allowing Pinnacle Bank to qualify for a CITC tax credit. This note had an outstanding balance of \$2.00 million as of June 30, 2013 and 2012, respectively.

FAHE also holds notes payable to US Department of Treasury (\$2,063,000) which uses verbiage consistent with EQ2 funding, but does not meet requirement 6, having an evergreen provision. FAHE decided to take the conservative stance and report this note as a noncurrent note payable on the statements of financial position.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2013 AND 2012

**Note 11 – 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 \$19,909,235 and \$17,625,231 as of June 30, 2013 and 2012, respectively. To further clarify, of the \$19,909,235 balance, FAHE is the first guarantor on the original \$1,106,182 and takes the position of second guarantor on the remaining member loan agreements. Historically, there has not been a loss on these loans since inception in 2003.

During fiscal year 2011, the Organization entered into an agreement with the Department of Local Governments of the Commonwealth of Kentucky to implement a Neighborhood Stabilization Program (NSP) in the amount of \$632,000. Five notes were written on FAHE paper, using NSP grant funding. These loans were made with no recourse.

**Note 12 – 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 insured by the Federal Deposit Insurance Corporation up to \$250,000 per depositor, per insured bank, for each ownership category. The Organization manages the cash position to mitigate and or eliminate any associated risk. In fiscal year 2013, the Organization entered into a sweep account agreement to ensure that all balances above the FDIC limits were insured.

The Organization provides mortgage loans primarily to low- and moderate-income individuals. Mortgage notes totaling \$24,545,687 and \$24,534,007 at June 30, 2013 and 2012, respectively, are secured by the property purchased or improved except as noted. At June 30, 2013 and 2012 notes totaling \$70,816 and \$83,600 respectively, 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 \$14,214,989 and \$13,807,202 at June 30, 2013 and 2012, respectively, are secured by the assets of the Organization with the exception of the unsecured amount as noted. At June 30, 2013 and 2012, \$176,635 and \$357,974 respectively, were unsecured.

Finally, the Organization receives a substantial percentage of its funding from government grants and other contributions. The Organization's management anticipates a reduction in such funding in coming years, and has taken measures to compensate for this decline.

**Note 13 – Subsequent Events**

Management of the Organization has considered subsequent events through September 16, 2013, the date this report became available for issuance.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2013

<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>U.S. Department of Treasury</u>			
NeighborWorks America	21.000*		\$ 651,000
<u>Department of Housing &amp; Urban Development</u>			
Passed through Kentucky Housing Corporation (KHC)			
Home Investment Partnership Program (HOME)	14.239*	HB10-0201-01	29,000
Home Investment Partnership Program (HOME)	14.239*	HB11-0201-01	232,500
Subtotal passed through KHC			<u>261,500</u>
Passed through Virginia Department of Housing & Community Development (VDHCD)			
Home Investment Partnership Program (HOME)	14.239*	04-HA-43	13,000
Home Investment Partnership Program (HOME)	14.239*	2012-25-HA	46,750
Subtotal passed through VDHCD			<u>59,750</u>
Passed through Local Initiatives Support Corporation			
HUD Section 4	14.252	B-09-CB-NY-0001	37,186
Passed through Department for Local Government			
Neighborhood Stabilization Program	14.228	11N-045	58,753
Total Department of Housing & Urban Development			<u>417,189</u>
<u>Appalachian Regional Commission</u>			
Passed through Kentucky Housing Corporation			
Appalachian Regional Development	23.001	KY-16798-10-03	215,064
Appalachian Regional Development	23.001	KY-16798-C1	203,351
Total Appalachian Regional Commission			<u>418,415</u>
<b>TOTAL FEDERAL AWARDS</b>			<u><u>\$ 1,486,604</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, 2013

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.

INDEPENDENT AUDITOR'S 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, in accordance with the 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, the financial statements of Federation of Appalachian Housing Enterprises, Inc. (a non-profit organization), which comprise the statements of financial position as of June 30, 2013, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated September 16, 2013.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of Federation of Appalachian Housing Enterprises, Inc.'s internal control.

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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **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 that are required to be reported under *Government Auditing Standards*.



CRAFT, NOBLE & COMPANY  
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## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Craft, Noble & Company, PLLC*

Craft, Noble & Company, PLLC  
Richmond, Kentucky  
September 16, 2013

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM  
AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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

**Report on Compliance for Each Major Federal Program**

We have audited Federation of Appalachian Housing Enterprises, Inc.'s compliance 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 Federation of Appalachian Housing Enterprises, Inc.'s major federal programs for the year ended June 30, 2013. Federation of Appalachian Housing Enterprises, Inc.'s major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

***Management's Responsibility***

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

***Auditor's Responsibility***

Our responsibility is to express an opinion on compliance for each of Federation of Appalachian Housing Enterprises, Inc.'s major federal programs based on our audit of the types of compliance requirements referred to above. 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 on compliance for each major federal program. However, our audit does not provide a legal determination of Federation of Appalachian Housing Enterprises, Inc.'s compliance.

***Opinion on Each Major Federal Program***

In our opinion, Federation of Appalachian Housing Enterprises, Inc. complied, in all material respects, with the types of compliance 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, 2013.



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PLLC

Certified Public Accountants  
Post Office Box 827  
Richmond, KY 40476

**Report on Internal Control Over Compliance**

Management of Federation of Appalachian Housing Enterprises, Inc. is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Federation of Appalachian Housing Enterprises, Inc.'s internal control over compliance with the types of requirements that could have a direct and material effect on

each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program 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 Federation of Appalachian Housing Enterprises, Inc.'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. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of 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 material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

*Craft, Noble & Company, PLLC*

Craft, Noble & Company, PLLC  
Richmond, Kentucky  
September 16, 2013



FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2013

SUMMARY OF AUDITOR'S RESULTS

1. The auditor's 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 auditor's report on compliance for the major federal awards programs 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.  
Home Investment Partnership Program (HOME) CFDA #14.239 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 HOUSING ENTERPRISES, INC.  
STATEMENT OF FUNCTIONAL EXPENSES  
FOR THE YEAR ENDED JUNE 30, 2013

Expenses	General &			Program Services					Total Program Services	Total
	Administrative	Membership	Fundraising	Home Lending	Community Development	Loan Servicing	FAHE Consulting	FAHE Capital		
Personnel Expenses	\$ 858,750	\$ 153,185	\$ 184,238	\$ 291,599	\$ 139,612	\$ 222,625	\$ 305,356	\$ 156,575	\$ 1,115,767	\$ 2,311,940
Travel Expenses	88,373	13,803	28,696	3,480	10,332	330	5,261	14,542	33,945	164,817
Board & Committee Meetings	8,482	520	80	-	-	-	-	-	-	9,082
Conferences & Workshops	12,848	3,578	6,420	195	1,217	-	487	1,341	3,240	26,086
Occupancy Expense	17,997	3,614	5,421	7,227	3,614	9,033	9,033	1,807	30,714	57,746
REO Expense	126,654	-	-	-	-	-	-	-	-	126,654
Supplies & Publications	5,687	1,350	2,222	2,237	1,617	5,789	2,796	559	12,998	22,257
Postage & Shipping	2,119	1	668	3,942	478	19,929	672	552	25,573	28,361
Communications	14,078	4,583	4,279	5,426	3,392	6,834	6,884	1,315	23,851	46,791
Equipment & Maintenance	26,630	5,524	9,516	10,652	5,326	13,465	13,315	2,663	45,421	87,091
Subscriptions	3,183	419	451	-	2,280	-	-	-	2,280	6,333
Licenses, Fees & Permits	483	200	200	17,072	-	-	-	525	17,597	18,480
Employee Education	38,708	5	442	1,131	250	99	1,055	6,519	9,054	48,209
Memberships	4,342	13,354	2,052	725	-	-	-	4,000	4,725	24,473
Marketing & Advertising	2,731	-	36,910	-	-	-	-	3,925	3,925	43,566
Liability & Property Insurance	16,794	3,359	5,038	6,922	3,359	8,422	8,397	1,679	28,779	53,970
Service Charges	6,231	-	777	5,326	6,231	22,585	-	-	34,142	41,150
Depreciation & Amortization	29,178	5,836	8,754	11,671	5,836	14,589	14,589	2,918	49,603	93,371
Organizational Expenses	15	-	-	-	-	-	-	1,194	1,194	1,209
Contributions	100	4,000	-	-	-	-	-	500	500	4,600
Software Lease	29,906	12	5,636	325	12	15,397	31	6	15,771	51,325
Professional Fees	20,533	4,107	7,523	8,213	4,187	11,481	10,416	2,053	36,350	68,513
Contract Services	98,408	-	123,242	6,903	-	1,200	56	2,156	10,315	231,965
Loan Processing Expense	-	-	-	6,549	41	-	-	-	6,590	6,590
Loan Servicing Expense	1,607	-	-	-	(508)	6,312	-	-	5,804	7,411
Pass Thru Grants	1,038,109	82,250	-	-	-	-	58,753	-	58,753	1,179,112
Administration	-	-	-	27,312	-	-	-	-	27,312	27,312
Bad Debt Expense	524,506	-	-	-	-	-	-	-	-	524,506
Interest Expense	584,806	-	-	-	-	-	-	-	-	584,806
Loans Forgiven	149,953	-	-	-	-	-	-	-	-	149,953
Miscellaneous Expense	1,508	-	-	-	20	-	11	-	31	1,539
<b>Total Expenses</b>	<b>\$ 3,712,719</b>	<b>\$ 299,700</b>	<b>\$ 432,565</b>	<b>\$ 416,907</b>	<b>\$ 187,296</b>	<b>\$ 358,090</b>	<b>\$ 437,112</b>	<b>\$ 204,829</b>	<b>\$ 1,604,234</b>	<b>\$ 6,049,218</b>

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
STATEMENT OF FUNCTIONAL EXPENSES  
FOR THE YEAR ENDED JUNE 30, 2012

Expenses	Program Services									Total Program Services	Total
	General & Administrative	Membership	Fundraising	Home Lending	Community Development	Loan Servicing	FAHE Consulting	FAHE Capital			
Personnel Expenses	\$ 898,654	\$ 147,741	\$ 69,839	\$ 289,096	\$ 117,466	\$ 174,414	\$ 226,192	\$ 205,197	\$ 1,012,365	\$ 2,128,599	
Travel Expenses	96,432	14,303	15,944	5,278	11,038	3,061	11,315	7,619	38,311	164,990	
Board & Committee Meetings	16,227	149	-	-	-	-	-	-	-	16,376	
Conferences & Workshops	11,181	3,664	990	288	368	349	893	2,193	4,091	19,926	
Occupancy Expense	39,367	3,551	1,774	7,102	1,806	7,070	6,078	4,303	26,359	71,051	
REO Expense	190,957	-	-	-	-	-	-	-	-	190,957	
Supplies & Publications	10,352	963	444	2,309	1,115	5,246	1,529	929	11,128	22,887	
Postage & Shipping	2,252	55	101	2,004	398	14,270	517	440	17,629	20,037	
Communications	24,479	2,257	1,177	4,172	1,066	4,172	3,470	2,431	15,311	43,224	
Equipment & Maintenance	30,920	5,419	2,551	9,707	2,425	9,707	7,448	5,259	34,546	73,436	
Subscriptions	4,971	272	1,350	-	-	-	-	27	27	6,620	
Licenses, Fees & Permits	337	2	29	14,916	30	4	703	296	15,949	16,317	
Employee Education	34,928	115	48	1,254	430	-	-	511	2,195	37,286	
Memberships	4,149	12,709	8	934	33	34	65	3,353	4,419	21,285	
Marketing & Advertising	61,290	-	39	-	-	-	-	7,625	7,625	68,954	
Liability & Property Insurance	22,597	4,232	2,116	8,471	2,116	8,471	6,355	4,232	29,645	58,590	
Service Charges	4,241	32	-	-	-	11,601	-	17	11,618	15,891	
Depreciation & Amortization	33,998	6,180	3,090	12,368	3,090	12,368	9,516	6,419	43,761	87,029	
Organizational Expenses	413	-	-	-	-	-	-	2,764	2,764	3,177	
Contributions	5,300	2,000	-	-	-	-	-	500	500	7,800	
Software Lease	21,740	999	471	2,715	495	19,924	1,952	1,479	26,565	49,775	
Professional Fees	37,395	6,797	3,399	13,604	3,921	19,032	10,206	18,327	65,090	112,681	
Contract Services	218,433	15,504	60,350	4,934	2,369	5,734	4,489	5,658	23,184	317,471	
Loan Processing Expense	21,147	-	-	3,732	-	-	-	-	3,732	24,879	
Loan Servicing Expense	7,337	-	-	-	-	4,793	-	-	4,793	12,130	
Pass Thru Grants	686,020	180,330	-	-	-	-	35,160	-	35,160	901,510	
Administration	-	-	-	27,416	-	-	-	-	27,416	27,416	
Bad Debt Expense	887,940	-	-	-	-	-	-	-	-	887,940	
Interest Expense	529,104	-	-	-	-	-	-	-	-	529,104	
Loans Forgiven	72,699	-	-	-	37	-	-	-	37	72,736	
Miscellaneous Expense	2,377	-	84	-	-	192	59	61	312	2,773	
<b>Total Expenses</b>	<b>\$ 3,977,237</b>	<b>\$ 407,274</b>	<b>\$ 163,804</b>	<b>\$ 410,300</b>	<b>\$ 148,203</b>	<b>\$ 300,442</b>	<b>\$ 325,947</b>	<b>\$ 279,640</b>	<b>\$ 1,464,532</b>	<b>\$ 6,012,847</b>	

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
 STATEMENTS OF FINANCIAL POSITION - NEIGHBORWORKS AMERICA CAPITAL FUND  
 JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
ASSETS		
Cash and cash equivalents	\$ 818,318	\$ 482,190
Mortgages receivable	161,956	141,682
Property held for sale	<u>19,726</u>	<u>-</u>
<b>TOTAL ASSETS</b>	<b><u>\$ 1,000,000</u></b>	<b><u>\$ 623,872</u></b>
NET ASSETS		
Temporarily restricted	\$ -	\$ 45,038
Permanently restricted	<u>1,000,000</u>	<u>578,834</u>
<b>TOTAL NET ASSETS</b>	<b><u>\$ 1,000,000</u></b>	<b><u>\$ 623,872</u></b>

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
 STATEMENTS OF ACTIVITIES - NEIGHBORWORKS AMERICA CAPITAL FUND  
 FOR THE YEARS ENDED JUNE 30, 2013 AND 2012

	<u>2013</u>	<u>2012</u>
<b>TEMPORARILY RESTRICTED NET ASSETS</b>		
Restrictions released from temporarily restricted net assets	\$ (45,038)	\$ -
DECREASE IN TEMPORARILY RESTRICTED NET ASSETS	<u>(45,038)</u>	<u>-</u>
<b>PERMANENTLY RESTRICTED NET ASSETS</b>		
Capital Grant-NeighborWorks America	500,000	282,000
Net assets released from restriction	<u>(78,834)</u>	<u>(64,300)</u>
INCREASE (DECREASE) IN PERMANENTLY RESTRICTED NET ASSETS	421,166	217,700
CHANGE IN NET ASSETS	376,128	217,700
NET ASSETS AT BEGINNING OF YEAR	<u>623,872</u>	<u>406,172</u>
NET ASSETS AT END OF YEAR	<u>\$ 1,000,000</u>	<u>\$ 623,872</u>

See Independent Auditor's Report.

FEDERATION OF APPALACHIAN HOUSING ENTERPRISES, INC.  
 COMPUTATION OF ADJUSTED NET WORTH FOR APPROVAL OF NONSUPERVISED  
 MORTGAGEES OTHER THAN LOAN CORRESPONDENTS  
 FOR THE YEAR ENDING JUNE 30, 2013

Minimum net worth required		<u>\$ 250,000</u>
Stockholders equity (net worth)		
Per balance sheet	\$ 21,677,991	
Less unacceptable assets	<u>\$ -</u>	
Adjusted net worth for HUD Requirement purposes		<u><u>\$ 21,677,991</u></u>
Adjusted net worth above amount Required		<u>\$ 21,427,991</u>
Adjusted net worth below amount Required		<u>\$ -</u>

See Independent Auditor's Report.