Accounting, Audit & Tax Workshop
For the Year Ended December 31, 2012

Presented By:
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November 30, 2012
Project Audits and Tax Returns:

Drafts: Due March 1, 2013
Finals: The Later of March 15, 2013 or Within eight (8) calendar days of the date MHIC issues its “Go Final” letter.
Overall Agenda

• Module One: Audit Process
• Module Two: Tax Process
• Module Three: Year 15 Plan
**Structure**

**IRS**

**State tax credit entity**

**The lender**

**Financing $$$$$**

**The developer of LIHTC building or project** - controls the operating entity

**1% GP**

**Entity which requests and receives tax credits** – typically a limited partnership/LLC which owns a housing project providing low income housing to qualified tenants

**Allocation of credits**

**Operating Partnership**

**The Syndicator**

negotiates the union between developers and investors

**GP of Fund**

Controls fund

**Syndication fee**

**The Fund**

- an investment partnership

**INVESTORS in the Fund**

**Credits!!**

**Invests $$$$ (LP of Fund)**

**99% LP**

**Credits!!**

**Invests $$$$**

**Low income housing**

**Qualiﬁed Tenants**

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Approach

- MHEF Funds use the equity method of accounting for its investment in each project partnership.
Upper tier accountant will:
- review the draft audit and tax returns of each project partnership.
- require and/or request selected documentation as part of the review process.
Upper tier accountant will:
- inquire and discuss items that may arise with MHIC and/or the lower tier accountant as needed.
- place reliance on the project partnership financial statements.
Audit Matters

– Please notify MHIC immediately if any of the following occur:

• Impairment
• Qualified Opinion/Disclaimer of Opinion
• Going Concern
• Restatement
• Amended Tax Returns
• Casualty Loss

THANK YOU FOR THE CALL!
Required Documentation – Year End Requirements

**Required for ALL deals**

- Signed Independence Letter
- Peer Review Report
- Minimum Gain Calculation
- Book to Tax Reconciliation
- Qualified Occupancy Summary
- Classifications of Loans – NR/QNR/R
- Details of any special tax allocations (profit-loss-credits-liabilities)
Required for **ALL First and Second Year Deals**

- Cost Certification, if applicable
- Draft 8609’s, if applicable
- Working Trial Balance (GAAP & Tax) and Financial Statement grouping sheets
Required for ALL First and Second Year Deals

- Fixed assets and fixed asset additions along with related depreciation (including FASB 144 calculations for asset impairment if applicable).
- Deferred costs and related amortization.
- Mortgage and loans payable along with related interest and confirmations. If no confirmations, please document how tested.
Required Documentation – Year End Requirements continued

Required for **ALL First and Second Year Deals**

- Partners equity showing changes in limited partner and general partner equity.
- Revenue and expense analytical review.
- Legal work paper and letter(s), if applicable
- Management representation letter
• Material tenant accounts receivable
• Escrow/Reserve activity detail not reconciled to third party statements
• Land included with building
• Construction payables included with accounts payable
Inclusion of entity expenses with operating expenses

Development fee/soft debt interest non-accrual

Debt not reconciled to third party statements

Failure to record non-cash transactions

Disclosure of guarantees
Sample Financial Statements are included in the MHIC Tax Return and Audit Preparation Guide.
Impairment is the condition that exists when the carrying amount of a long-lived asset exceeds its fair value. An impairment loss shall be recognized only if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset.
Impairment

Examples of Triggering Events:

• A significant decrease in the market price of a long-lived asset
• A significant adverse change in the extent or manner in which a long-lived asset is being used or in its physical condition
• A significant adverse change in legal factors or in the business climate that could affect the value of a long-lived, including an adverse action or assessment by a regulator
Examples of Triggering Events – Continued

• An accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of a long-lived asset.

• A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of a long-lived asset.

• A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.
Impairment

- Recoverability Analysis:
  - Carrying value vs. sum of undiscounted cash flows
  - If the carrying value of the asset exceeds the sum of the undiscounted cash flows, the asset is impaired and must be written down to fair value.
Impairment

• Fair Value – Some Considerations:
  – Value of the tax credits
  – Value of the future expected cash flows
  – Original underwriting projections
  – Appraisals
Management Responsibilities

- Financial Statements are the responsibility of the organization’s management.
- Financial Statements should be in accordance with GAAP.
- Management is responsible for ensuring internal controls are in place and operational.
Management Responsibilities

• Books are maintained on the accrual basis of accounting
• All transactions including cash and non-cash are recorded in the general ledger and reconciled at year end
• Development and operating activity are consolidated and reconciled
Management Responsibilities

- Maintenance of supporting documentation
- Any new debt, debt modifications or restructurings are properly accounted for and supported by signed documents
Management Responsibilities

• Responsible for compliance with laws and regulations and for making the auditor aware of those requirements

• Completion of accurate qualified occupancy summaries for all LIHTC properties (including 100% deals)
Auditor Responsibilities

- Timely Service
- Reasonable deadlines for information requested
- Reasonable staff continuity
- Independence
- Partner involvement
- Compliance with audit requirements
Auditor Responsibilities

- Express an opinion on the financial statements based on audit results
- Preparation of tax returns based on information provided by management
Auditor Expectations

- Staff availability/cooperation
- Supporting schedules
- Information provided timely
- Forms and checklist completion
- Knowledge of and responsibility for financial statement preparation and GAAP
• Prefer tax basis
• Schedule L on Book Basis/K-1 Tax Basis
Tax Pitfalls

• Including reserves in acquisition basis

• Capitalizing 100% of interest, taxes and insurance into rehab basis

• Failure to maximize credits:
  – Focus on building with fewest market tenants first
  – Fill entire building first
  – Consider moving market rate tenants to other buildings
Tax Pitfalls - Continued

• Not looking at operating statement when preparing cost certification to see if there are capitalizable costs paid for out of operations to increase tax credit basis
• Not meeting expected lease-up
• Not tracking qualified occupancy (i.e. lower of area or units)
• Failure to timely plan, prepare and complete cost certification
Tax Pitfalls - Continued

• Failure to timely secure 8609’s from the housing finance agency
• Electing improper elections on Section II of the 8609 (i.e. set a-side election)
• Improper liability allocation
• Improper cut-off of qualified expenditures for HTC
Minimum Gain

- Minimum Gain is the excess of nonrecourse liabilities which are secured by the partnership property over the adjusted tax basis of the property.

- Rules prescribed under 704(b) limit the losses allocated to limited partners to their capital contributions, their previous share of income and losses plus their share of minimum gain.

- Pre-emptive Reallocation

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Occupancy Issues

• Minimum set-aside requirement
  – 40-60 rule
  – 20-50 rule

• Client must meet set-aside requirements by year end or project will not qualify for that year’s tax credits (deferral)

• Set aside requirements apply throughout the compliance period (15 years)
Deferred Developer Fees

One of the most significant issues encountered in low income tax credit cases stems from the inclusion or general allowance of developer fees in the reported eligible basis of the respective real estate projects.

Internal Revenue Manual MSSP Training Guide Chapter 11
COD Income

- Debt Modification that must be tested for COD income
  - Change from recourse to non recourse or vice versa
  - Change in payment expectation
  - Different asset securing nonrecourse debt
  - Change in obligator on a recourse debt
Year 15 Issues

– When to Exit
  • Tax Credit Compliance ends on the last day of the 15th year since the credits were first claimed on the tax return
  • May be different for different buildings
  • Need to be thinking about Year 15 issues long before Year 15 – strategy should be decided in year 13, prepared for in year 14 and executed in year 15

– COD Income
– Lender Consents
– Assignment and Assumption Agreements
– Formation of New entities
Year 15 Issues

– Know the **property**
  • Is cash flow sufficient to sustain it?
  • What are the anticipated changes, such as a loss of a subsidy?
  • Is the property in good shape, what are the capital needs?
  • What’s the current market, what’s the market projected to be

– Know the **stakeholders**, what do they want?
  • Residents
  • Investors
  • Lenders
  • Allocating agencies
– Know what your documents say you can do and cannot do.

• Is there a purchase option?
• Is there a “Right of First Refusal” (ROFR) (Section 42 requirements?
• How are the proceeds to be split?
• Are there disposition fees?
• What issues are negotiable?
• Investor Income Issues
• Assignment and Assumption Issues
Year 15 Issues – When to Exit

– Many Options

• Sponsor acquires property and continues operations, assuming all existing debt.
• Sponsor acquires and rehabs through re-syndication and/or refinancing – new entities
• Sponsor acquires and sell to third party
• Partnership sells to third party
• Homeownership (lease-purchase, condos)
• “Qualified contract”
• Remember “exit taxes” – tax return due date
• Remember an audit may still be required –
  – Know your regulatory agreement.
The End – Thank You!