

# New Guidelines Could Increase Cost of LIHTC Audits

By Michael J. Novogradac, CPA

Characterized by the Housing Advisory Group (HAG) as “perhaps the greatest threat to the LIHTC program on the radar today,” recently implemented federal audit guidelines for public companies could force a substantial increase in costs for the annual audits for many low-income housing tax credit (LIHTC) properties and for the funds that own them.

A little background is in order. The Securities and Exchange Commission (SEC) in January agreed with the Public Company Accounting Oversight Board (PCAOB) that if the principal auditor of a public company refers to the audit reports of lower-tier operating limited partnerships in cases where a public company invests in other companies, then the audit of those operating partnerships must be performed according to, and the operating partnership’s auditor’s audit opinion must refer to the standards of PCAOB. According to HAG, this position “may be of much greater short-term impact than tax reform.”

This impact on the program comes from the Sarbanes-Oxley Act of 2002 (SOX), which created the private sector, not-for-profit PCAOB, and the subsequent accounting standards that have resulted from the legislation enacted in response to Enron and other public company scandals. Prior to Internal Revenue Code Section 42 being extended indefinitely, most LIHTC properties were packaged into funds and marketed to the individual (public) market. Although most of the present day investment in the LIHTC program is institutional, there still are companies that market public funds.

In 2005 PCAOB issued guidance that said that audits of operating partnerships in which LIHTC funds have invested must be performed according to PCAOB standards if investment in these funds is offered to the public. Then, in January, SEC staff announced their interpretation of the guidance, potentially making future and existing LIHTC properties sold to the public economically unworkable. According to David Gasson, HAG’s executive director, owners of existing tax credit properties have a very limited ability to cover the additional expense of a PCAOB audit because the rents of their properties are capped.

“To be succinct and to the point,” says Gasson in an update to the organization’s members, “the issues involve substantially increased costs at both the operation and limited partnership levels for the annual audits of the properties and the funds that contain them; the ability of the accounting firms for the operating partnerships to meet the PCAOB audit standards; and for those firms to meet the SEC/PCAOB criteria for CPA independence.”

The SEC/PCAOB independence rules prohibit an auditor from preparing or assisting in the preparation of the financial statements. However, in the LIHTC industry the operating partnership auditors in many cases prepare the financials. The question then becomes, will the operating partnership auditors be able to issue a PCAOB standards opinion or will they lack independence?

There are several differences between generally accepted auditing standards (GAAS), which apply to all non-public companies, and PCAOB standards, which apply to public companies, says Diane Rubin, a partner in Novogradac & Company LLP’s San Francisco office, adding that PCAOB standards require additional audit documentation, mandatory concurring partner reviews, auditor rotation and more restrictive independence rules. “Of course, we share the goal of achieving improved public company financial statements and performing rigorous audits,” says Rubin, who also serves as Chair of the National Association of State Boards of Accountancy (NASBA) for 2005-2006. “However, we must try to avoid making this process too burdensome, especially for smaller companies.”

In addition to the new standard having a significant financial effect on existing public partnerships that have invested in LIHTC investments for more than 15 years, the new standard will seriously impair the ability to raise capital from individuals to make investments that produce and rehabilitate LIHTC properties, accordingly to HAG. HAG also notes that the new standard provides no additional protection to investors in limited partnerships that are already subject to a very stringent state and federal regulatory structure.

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In a February 21 member update, HAG wrote that it had formed a small working group and had scheduled a meeting with PCAOB and chief accountant and legal staff of the SEC. "Despite their acknowledgement of the effects the new standards would have on the industry, we received word from the SEC that they felt it would set a dangerous precedent for them to grant relief to the LIHTC industry," the update stated.

Subsequent to the February update, HAG took its case to congressional committees, meeting on March 21 with senior counsel and two staff counsel for the House Financial Services Committee to discuss the PCAOB audit issue. At that meeting HAG representatives provided a brief, detailed primer on the LIHTC program, delved into the issue, and explained the structure of the limited partnerships, the economics of the program and the difficulties presented by the PCAOB and SEC audit guidelines. "Although this was an initial meeting, we were pleased with the specific

questions asked by the staff and the tone of their inquiries," says Gasson, who is also vice president for Boston Capital Corporation. "We left the meeting with the sense that they understood the difficulties associated with the audit guidelines as well as why, in this case, the requirements are not in the best interest of the investors or the program." The SEC has shown some willingness to accommodate the industry's requests by indicating it would waive the requirement, through December 31, 2005, that lower-tier audits of tax-credit properties be conducted by an independent auditor. Other congressional committee meetings were planned.

As the Housing Advisory Group continues to seek to resolve this PCAOB audit report issue and the related rising audit costs, additional help is needed. In the absence of a positive resolution and in the face of already rising insurance, energy and other operating costs, many LIHTC partnerships will see an increase in auditing costs. ❖