

WISCONSIN HOUSING AND ECONOMIC DEVELOPMENT AUTHORITY
Low Income Housing Tax Credit (LIHTC) Program

COST CERTIFICATION AUDIT GUIDE

REVISED MARCH 26, 2010

BACKGROUND

Owners of Projects consisting of more than 10 units are required to submit, with the final application for credit, an audited schedule of costs and eligible basis (cost certification) in accordance with generally accepted auditing standards. For Projects of 10 units or less, a cost review is required.

This audit guide is intended to provide guidance to auditors performing cost certifications for Projects receiving an allocation of affordable housing tax credits from WHEDA. Included in this guide are:

- * Audit program for performing the cost certification
- * Sample independent auditor's report
- * Sample engagement letter
- * Sample representation letter

AUDIT PROGRAM

Note: This audit program is designed to provide guidance regarding specific audit procedures which should generally be performed for a cost certification. As with any audit engagement, other procedures required by generally accepted auditing standards may be required. As with any audit program, this program is not intended to be a substitute for prudent auditor's judgment.

1. Confirm your understanding of the terms of your engagement with the Project owner.
2. Obtain copies of syndication agreements, development agreements, general contractor agreements and change orders, architect agreements, financing agreements and any other documents deemed necessary to determine that costs are fairly stated.
3. Obtain an understanding of the financial structure and other relevant aspects of the Project. Consider reviewing forecasts and/or projections previously prepared for the Project.
4. Determine if any identity of interest relationships exist between the owner/developer and the general contractor and/or any subcontractors. (Refer to LIHTC Application Appendix Identity of Interest restrictions.)
5. Determine the year of the credit allocation and obtain an understanding of the eligible basis limitations for related party and other fees applicable to this Project.
6. Obtain a detailed schedule of acquisition, construction and/or rehabilitation costs, including all soft costs, from the Project owner or developer. The schedule should include estimated payables to complete the development of the Project.
7. Obtain certificates of occupancy or substantial completion to ascertain that construction/rehabilitation has been completed.
8. Examine supporting documentation for a sample of Project costs listed on the schedule obtained in step #6 including evidence to support the estimated payables to the extent possible.
 - a) If there is not an identity of interest relationship, costs relating to the general construction contract should be traced to the underlying AIA contract and any change orders. If there is an identity of interest relationship, examine underlying invoices for costs incurred by the general contractors for materials and subcontractors. As part of this procedure, examine services or materials provided to ascertain proper asset categorization between buildings, site work, landscaping, personal property, general requirements and contractor overhead, and to ascertain the costs relate to this Project.
 - b) Examine detailed invoices supporting costs incurred by the Project outside of the construction contract. Review invoices to ascertain the costs relate to this Project and that costs have been properly categorized.
 - c) For costs considered general requirements or overhead, you are not required to review the underlying invoices for reasonableness (this includes labor allocations, for which you do not need to review the reasonableness or methodology of the labor charge-backs). See attached description of examples of general requirements.

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ATTACHMENT TO COST CERTIFICATION AUDIT GUIDE

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Note: Specific categories referred to below represent categories listed in Project Costs and Credit Calculation section of LIHTC Application. Please refer to the LIHTC Application for further information.

FEE CAPS FOR COMPUTING ELIGIBLE BASIS

Architectural Fee Cap

For eligible basis purposes the sum of design and supervision fees in Category E cannot exceed:

- **\$3,000 per unit (\$3,500 per unit for historic rehabilitation)**

For actual Project cost there is no per-unit architectural cost limit.

2006 Project Example: 28-unit new construction Project. Total architectural fees for design and supervision, in aggregate, cannot exceed \$84,000 (28 units x \$3,000) in eligible basis.

General Requirements, Contractor Overhead and Contractor Profit Caps

Limited to **14%**, detailed below:

(Note: These limits refer to actual Project costs and not just eligible basis costs.)

I. **General Requirements are limited to 6% of the aggregate of the following:**

- ◆ Site work in subtotal Category B
- ◆ New building costs in Category C
- ◆ Rehabilitation costs in Category C
- ◆ Accessory building costs in Category C
- ◆ Other costs in Category C

II. **Contractor Overhead is limited to 2% of the aggregate of the following:**

- ◆ Site work in subtotal Category B
- ◆ New building costs in Category C
- ◆ Rehabilitation costs in Category C
- ◆ Accessory building costs in Category C
- ◆ Other costs in Category C
- ◆ Eligible General Requirements as calculated above

III. **Contractor Profit is limited to 6% of the aggregate of the following:**

- ◆ Site work in subtotal Category B
- ◆ New building costs in Category C
- ◆ Rehabilitation costs in Category C
- ◆ Accessory building costs in Category C
- ◆ Other costs in Category C
- ◆ Eligible General Requirements as calculated above
- ◆ Eligible Contractor Overhead as calculated above

Example Project Costs:

Site work in subtotal Category B	\$ 185,000
New building in Category C	5,900,000
Other costs in Category C	<u>72,000</u>
Subtotal	<u>\$6,157,000</u>
General requirements in Category C	\$ 400,000
Contractor's overhead in Category C	\$ 140,000
Contractor's profit in Category C	\$ 425,000

General Requirements Limitation is calculated as follows:

Subtotal above	\$6,157,000
Multiplied by 6%	<u>x 6%</u>
Limitation	<u>\$ 369,420</u>

General Requirements exceed the limitation of \$369,420. Accordingly, only \$369,420 of the \$400,000 may be included in eligible basis.

Contractor Overhead Limitation is calculated as follows:

Subtotal above	\$6,157,000
Eligible general requirements (Lesser of Actual or calculated above)	<u>369,420</u>
Subtotal #2	\$6,526,420
Multiplied by 2%	<u>x 2%</u>
Limitation	<u>\$ 130,528</u>

Contractor Overhead does not exceed the limitation of \$130,528. Accordingly, the entire \$100,000 may be included in eligible basis.

Contractor Profit Limitation is calculated as follows:

Subtotal #2	\$6,526,420
Eligible general requirements (Lesser of Actual or calculated above)	<u>100,000</u>
Subtotal #3	\$6,626,420
Multiplied by 6%	<u>x 6%</u>
Limitation	<u>\$ 397,585</u>

Contractor profit exceeds the limitation of \$397,585. Accordingly, only \$397,585 of the \$425,000 may be included in eligible basis.

Developer Fee Cap

There is a limit on developer fees in Category X, including all developer fee items in Category J and construction supervision fee in Category C. For Projects of **24 units or fewer**, this limit is equal to **15%** of total Project costs, net of these costs. For Projects with **more than 24 units**, this limit is equal to **12%** of total Project costs, net of these costs. (Refer to WHEDA's Developer Fee Policy in Appendix K of the LIHTC Application and the Identity of Interest restrictions.)

Example Project Costs:

Total Project costs	\$9,000,000
Less developer fees	(900,000)
Less developer overhead	(43,000)
Less consultant fees	(50,000)
Subtotal	(\$8,007,000)
	<u>x 12%</u>
Limitation	<u>\$ 960,840</u>

The total fees subject to this limitation are \$993,000 (\$900,000 + \$43,000 + \$50,000). In this example, only \$960,840 of the developer's fees may be included in eligible basis.

CONTRACTOR GENERAL REQUIREMENTS

General requirements for standard on-site third-party expenditures will not be counted toward the General Requirements limitation. However, other general requirements are subject to the 6% limitation (see above) under the contractor rules. Costs excluded from General Requirements calculations (if costs are incurred with vendors not related to the general contractor or developer):

- * Building Permits
- * Field Engineering Expenses
- * Temporary Toilets or Storage Sheds
- * Rubbish Disposal and Dumpster Rental
- * Security Services
- * Temporary Roads or Access Rentals
- * Construction Signage
- * On-site Non Construction Supervision Costs

Costs included in General Requirements calculations and limitations, whether or not paid to outside parties:

- * Construction Supervision Costs
- * Field Office Expenses
- * Builders Insurance
- * Equipment Rental or Purchase

(These are general contractor costs that are part of performing the required duties.)

- d) Developer labor allocations, telephone charge allocations, mileage reimbursements, auto lease allocations, etc. may be considered developer fees or overhead and subject to the fee limitations for eligible basis calculations. You are not required to review the detail substantiating these costs or allocations for reasonableness, since they will be considered part of the contracted development fee.
 - e) Test cut-off of interest, real estate taxes and insurance costs for proper capitalization.
 - f) Inquire whether there have been any environmental clean-up concerns.
 - g) If there are cost overruns review applicable documents and discuss with the owner/developer how the overruns are to be accounted for (i.e., additional capital, reduction in developer fee, increased deferred fee, etc.).
9. Identify sources of Project financing. Obtain documentation for construction loan activity or of cash/escrow accounts to determine that uses of funds presented in draw requests were actually expended.
10. Determine if costs are of a type that are depreciable and, therefore, a cost eligible for tax credits.
- a) Determine whether there are any off-site improvements in the AIA contract or Project budget.
 - b) Determine whether the Project has commercial space, community centers, etc. If so, obtain methodology used by the owner/developer to allocate costs between commercial and residential property and evaluate reasonableness of methodology used.
 - c) Determine whether the Project has separate charges to tenants for amenities such as parking, storage units, laundry hook-ups, etc. and whether these charges, when added to tenant rents, exceed the maximum rent limits. If so, obtain cost allocations from client for these amenities. The cost for amenities are not eligible basis items if the cost to the tenants for use of the amenities, when added to the rents, exceeds the maximum rent limits.
 - d) **WHEDA requires an itemized schedule describing those items not included in eligible basis:**
 - * **Offsite improvements (outlined in 10.a) directly above).**
 - * **Allocation between commercial and residential property (outlined in 10.b) directly above).**
 - * **Allocation of cost for those amenities exceeding maximum rent levels as described in 10.c) above.**
 - e) Review financing documents to determine whether financing is in the form of loans or grants. If the Project has received a grant, determine what costs were to be paid for with the grant proceeds under the terms of the grant agreement. If the costs paid normally are included in eligible basis, the eligible basis of these costs must be reduced by the amount of the grant proceeds used to pay for these costs.
11. For rehabilitation Projects, determine when the 24 month window was shut down for the proper inclusion of costs in eligible basis.
12. Review fee limitations for general requirements, contractor overhead and contractor profit. These items are treated as profit centers and in the aggregate can not exceed the 6%/2%/6% limitations of total Project costs. See attached examples for items to be included in the base for these calculations. *(If a line item in the AIA schedule of values exceeds its particular limitation, a reallocation to one of the other profit centers is permitted.)*
13. Review fee limitation of development fees. For Projects with 24 units or less, the amount of developer fee, (including deferred portion), construction supervision, developer overhead and consultant fees, in the aggregate, cannot exceed 15% of the total Project costs, net of these costs and fees. For Projects with more than 24 units, this limitation is 12% of the total Project costs, net of these costs and fees. (Refer to WHEDA's Developer Fee Policy.)
14. If an identity of interest relationship exists, consider whether the general contractor ("GC") entity is a legitimate operating concern. The GC must, at a minimum, meet the following criteria:
- * The party acting as GC holds itself out as a GC.
 - * GC has entered into a construction contract (preferably an AIA contract) with the Project owner.
 - * GC bears risk on construction contract (i.e., GC insurance).
 - * GC is responsible to engage and be responsible for subcontractors for the construction. The GC should have entered into subcontract agreements with each subcontractor. If there are only a few subcontractors, consider the legitimacy of the GC's claim to be the GC.

- * The party acting as GC has the knowledge and expertise to act as GC.
- * GC is responsible for approving change orders with and payments to subcontractors.
- * If it is determined the GC with an identity of interest relationship is not performing in a GC capacity, disclose finding on face of schedule of costs and eligible basis. Any fees taken are to be reclassified as additional development fee.

15. Summarize procedures performed and percentage of costs reviewed.
16. Perform a search for commitments and contingencies related to the cost certification. Inquire of the owner/developer about the possibility of contingencies or commitments regarding:
 - a) Pending litigation or unasserted claims
 - b) Irregularities involving management or employees that could affect the cost certification.
 - c) Communications from regulatory agencies regarding violations or possible violations.
 - d) Purchase commitments.
 - e) Anticipated losses on long-term contracts.
 - f) Financial transactions or arrangements with financial institutions (e.g., guarantees, endorsements, open letters of credits)
 - g) Designation as a potentially responsible party by the U.S. Environmental Protection Agency.
17. Perform a review for subsequent events to the date of the auditor's report. Procedures should be relevant to the cost certification.
18. Obtain a representation letter from the Project owner/developer. At a minimum, the letter should include:
 - * Representation that the owner/developer has not received any kickbacks, reimbursements or other forms of remuneration from the contractor or any other vendors.
 - * Representation that there are no off-site improvements included in the AIA contract or Project budget, if appropriate.
19. Draft or assist the owner/developer in drafting the final cost certification in the prescribed format (into actual costs categories). Draft independent auditor's report.
20. Consider the need to apply one or more additional procedures.
21. Verify that all procedures are in accordance with IRS Technical Advise Memorandums.

CONCLUSION

We have performed procedures to achieve the objectives of this audit program. The results of those procedures are adequately presented in the accompanying work-papers.

WISCONSIN HOUSING AND ECONOMIC DEVELOPMENT AUTHORITY
Low Income Housing Tax Credit (LIHC) Program

SAMPLE AUDITOR'S REPORT

(On Firm letterhead)

INDEPENDENT AUDITOR'S REPORT

To the Partners

Client Name

City, Wisconsin

We have audited the accompanying schedule of costs and eligible basis of WHEDA Project LIHC # _____ of *Client Name* as of *Date (schedule)*. This schedule is the responsibility of the partnership's management. Our responsibility is to express an opinion on the schedule based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall schedule presentation. We believe our audit provides a reasonable basis for our opinion.

In our opinion, the schedule referred to above presents fairly, in all material respects, the costs and eligible basis of WHEDA Project LIHC# _____ of *Client Name* as of *Date*, in conformity with Internal Revenue Code Section 42 and WHEDA requirements as they relate to eligible basis.

This report is intended solely for the information and use of the partners and management of *Client Name* and WHEDA and should not be used for any other purpose.

Report Date

WISCONSIN HOUSING AND ECONOMIC DEVELOPMENT AUTHORITY
Low Income Housing Tax Credit Program

SAMPLE ENGAGEMENT LETTER

Date

Client Name
555 Main Street
Anytown, WI 55555-5555

Attn: *Project Owner/Developer Name*

We are pleased to confirm our understanding of the services we are to provide for WHEDA Project LIHC # _____ of *Client Name* as of *Date*.

We will audit the schedule of costs and eligible basis (herein referred to as “the schedule”) of WHEDA Project LIHC # _____ of *Client Name* as of *Date*.

The objective of our audit is the expression of an opinion about whether your schedule of costs and eligible basis is fairly presented, in all material respects, in conformity with the Internal Revenue Code Section 42 and WHEDA requirements as they relate to eligible basis. Our audit will be conducted in accordance with generally accepted auditing standards and will include tests of your accounting records and other procedures we consider necessary to enable us to express such an opinion. If our opinion is other than unqualified, we will discuss the reasons with you in advance. If, for any reason, we are unable to complete the audit or are unable to form or have not formed an opinion, we may decline to express an opinion or to issue a report as a result of this engagement.

Our procedures will include tests of documentary evidence supporting the transactions recorded in the schedule. At the conclusion of our audit, we will require certain written representations from you about the schedule and related matters.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested. Also, we will plan and perform the audit to obtain reasonable assurance about whether the schedule is free of material misstatement. Because of the concept of reasonable assurance and because we will not perform a detailed examination of all transactions, there is a risk that material errors, fraud or other illegal acts may exist and not be detected by us. In addition, an audit is not designed to detect errors, fraud or other illegal acts that are immaterial to the schedule. However, we will inform you of any material errors that come to our attention and any fraud that comes to our attention. We will also inform you of any other illegal acts that come to our attention, unless clearly inconsequential. Our responsibility as auditors is limited to the period covered by our audit and does not extend to any later periods for which we are not engaged as auditors.

Our audit will include obtaining an understanding of the related internal controls sufficient to plan the audit of the schedule and to determine the nature, timing and extent of audit procedures to be performed. An audit is not designed to provide assurance on internal control or to identify reportable conditions, that is, significant deficiencies in the design or operation of internal control. However, during the audit, if we become aware of such reportable conditions, we will communicate them to you.

We understand that you are responsible for making all financial records and related information available to us and that you are responsible for the accuracy and completeness of that information. We will advise you about appropriate accounting principles and their application and will assist in the preparation of the schedule, but the responsibility for the schedule remains with you. This responsibility includes the establishment and maintenance of adequate records and effective internal controls over financial reporting, the selection and application of accounting principles and the safeguarding of assets. Management is also responsible for identifying and ensuring that the entity complies with applicable laws and regulations.

Our fees are based upon the time required by the individuals assigned to the engagement, plus direct expenses. Individual hourly rates vary according to the degree of responsibility involved and the skill required. Monthly billings will be submitted as services are rendered and as expenses are incurred. Billings are due upon submission.

We appreciate the opportunity to be of service to you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us.

Sincerely,

AUDITING FIRM NAME

Signature Block

Encl.

RESPONSE:

This letter correctly sets forth the understanding of *Client Name*.

Signature

Date

WISCONSIN HOUSING AND ECONOMIC DEVELOPMENT AUTHORITY
Low Income Housing Tax Credit (LIHTC) Program

SAMPLE REPRESENTATION LETTER

Date

CPA Firm Name

Address

City, WI 55555-5555

Dear Sir or Madam:

We are providing this letter in connection with your audit of the schedule of costs and eligible basis (herein after referred to as "the schedule") of WHEDA Project LIHC# _____ of *Client Name* as of *Date* for the purpose of expressing an opinion as to whether the schedule presents fairly, in all material respects, the costs and eligible basis of WHEDA Project LIHC# _____ of *Client Name* in conformity with the Internal Revenue Code Section 42 and WHEDA requirements, as they relate to eligible basis. We confirm that we are responsible for the fair presentation in the schedule of costs and eligible basis in conformity with the Internal Revenue Code Section 42 and WHEDA requirements, as they relate to eligible basis. We are also responsible for adopting sound accounting policies, establishing and maintaining the related internal controls and preventing and detecting fraud.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that in light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during your audit:

1. The schedule referred to above is fairly presented in conformity with the Internal Revenue Code Section 42 and WHEDA requirements, as they relate to eligible basis.
2. We have made available to you all:
 - a. Financial records and related data, including development, general contractor and syndication agreements.
 - b. Minutes of the meetings of partners or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the schedule.

5. There has been no:
 - a. Fraud involving management or employees who have significant roles in internal control.
 - b. Fraud involving others that could have a material effect on the schedule.
6. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities. In that regard, all of the land and property and equipment costs detailed in the schedule are for assets to be used in the operations of WHEDA Project No. LIHC # _____ of *Client Name* and are not being held for future development of another project.
7. The following have been properly recorded or disclosed in the schedule:
 - a. Related party transactions.
 - b. Amounts of contractual obligations for construction and/or purchase of real property, equipment, other assets and intangibles.
 - c. All liabilities incurred in the development of the project.
8. There are no estimates that may be subject to a material change in the near term that have not been properly disclosed in the schedule. We understand that "near term" means the period within one year of the date of the schedule. In addition, we have no knowledge of concentrations existing at the date of the schedule that make the company vulnerable to the risk of severe impact that have not been properly disclosed in the financial statements.
9. There are no:
 - a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the schedule or as a basis for recording an adjustment to the schedule. In that regard, we specifically represent that we have not been designated as, or alleged to be, a "potentially responsible party" by the Environmental Protection Agency in connection with any environmental contamination.
 - b. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed under Statement of Financial Accounting Standards No. 5.
10. The partnership has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
11. We have complied with all aspects of contractual agreements that would have a material effect on the schedule in the event of noncompliance.
12. No events have occurred subsequent to the schedule date and through the date of this letter that would require adjustment to the schedule.
13. We have identified all accounting estimates that could be material to the schedule of costs and eligible basis, including the key factors and significant assumptions underlying these estimates, and we believe the estimates are reasonable in the circumstances.

14. We have informed you that:
- a. There are no identity of interest relationships between *Client Name* and any other vendors utilized in developing and constructing the property.
 - b. There are no off-site improvements included in the costs incurred or remaining to be incurred by the partnership.
 - c. We are entitled to receive a development fee for at least \$_____.
 - d. We have not received any reimbursements, kickbacks or other forms of remuneration from any vendors.
 - e. There will be no separate charges to the tenants for parking, storage units or any other amenities.
 - f. The project was placed in service on _____.
 - g. Working capital reserves of \$_____ have been or will be funded.
 - h. The construction and permanent loans are separate loans under tax laws, and the construction loan fees are properly included in eligible basis.
 - i. The allocation of landscaping costs between non-depreciable and depreciable, as reflected in the schedule, is reasonable and appropriate. (Refer to: IRS TAM 200043017).

Sincerely,

CLIENT NAME

Owner Name
Title