TELLING YOUR STORY

Through Financial Statement Disclosures and More

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It can be challenging for Controllers and CFOs to ensure that their organizations consistently deliver accurate information to financial statement readers. Each time an annual report is issued to the public, along with accompanying financial statements and disclosures, questions arise as readers attempt to interpret information for various uses, including:

- Lenders who are primarily interested in liquidity of the parent organization in order to make a lending decision to that entity;
- Donors who are primarily interested in the level of accomplishments of the entire enterprise in order to make a funding decision;
- Governmental agencies that may be focused on how their policies are supporting the targeted beneficiaries of the organization; and
- Internal management or the board of directors whose long-term interest is in the sustainability of the organization and its programs.

In addition to the financial executives above, the CEOs, board members and other members of the management team within an organization also receive such inquiries. How can an organization ensure that the responses provided are consistent, accurate, and best position the organization to attract more capital in the future?

The overriding concern of the Strength Matters initiative since it was created in 2007 has been how to attract more enterprise-level capital to nonprofit developers of affordable housing. Part of the solution lies in helping organizations to build more transparency and consistency into their financial reporting models.

As LvHJ's representative in the Strength Matters collaborative, I've created many papers, which are available on the Strength Matters website, illustrating various techniques to help solve this problem. In essence, these papers can help affordable housing developers tell the unique story of their organization to support a variety of audiences and uses. The most important use, of course, is attracting more capital investment.

The following are three ways that CFOs or controllers of these not-for-profit organizations can accurately share their financial story.

Which key financial elements should be highlighted in your organization's unique story? Read our blog post

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MANAGEMENT DISCUSSION AND ANALYSIS (MD&A)

Not-for-profit organizations are not required to produce an annual MD&A. Although FASB recently considered making this mandatory, the stance was retracted due to the cost burden involved. As an alternative, Strength Matters asked me to create a sample MD&A for a non-profit affordable housing developer with multiple business lines, including housing development, property management, resident services and homebuyer lending. The resulting sample MD&A is available at www.strengthmatters.net through a subscription fee.

Only public companies and governmental agencies are required to produce an annual MD&A to enhance the public's awareness about items that an annual financial statement may only provide a limited amount of disclosure, including:

- A description of the organization's mission, activities, program and financial performance, systems, controls, legal compliance and financial condition;
- Future effects on the entity from existing demands, risks, uncertainties, events, conditions and trends including both positive and negative information;
- Management's strategies for dealing with significant trends;
- A description of the organization's financial condition, liquidity and capital resources, changes in financial condition and results of operations; and
- A longer-term view of the organization's operating results, such as three to five years, instead of the two years commonly presented in the audited financial statements.

Rather than requiring too much unnecessary complexity in an MD&A for affordable housing entities, the sample created through Strength Matters was a joint effort that I led among a group of CFOs and lenders. As we created the document, we focused first on how best to present a summary of a complex enterprise's efforts and accomplishments during the year. This effort begins with common financial ratios over an extended number of years based on information reported in the annual financial statements. But an important aspect of the MD&A is a forward look to identify future trends. The resulting document includes data on the key lines of business, the property portfolio, key financial ratios by business line, a project pipeline list with anticipated future developer fee income by year, the lending portfolio and loan payment delinquencies.

Other aspects of the sample MD&A enable an organization to tell its story consistently. Sending the MD&A along with the annual report would go a long way towards answering the types of questions that CFOs and controllers devote a good deal of time to answering. Saving time is one benefit, but an added benefit is the organization's increased control over the message as written in the MD&A, compared to what might be said by various members of management when prompted for "off-the-cuff" information, or explanations.

Other highlights from the sample MD&A include:

- A section on an organization's mission that includes an overview of the problems that the organization tries to solve;
- Financial ratios presented for each of the preceding five years, separately for the parent organization and for the real estate portfolio;
- A section on cash resources that identifies the amount of cash obtained from investors, lenders and from operating activities during each of the past two years as well as future sources of liquidity, such as untapped lines of credit;
- A section on future opportunities, risks, outlooks and obligations, such as a table of contractual obligations and discussion of related party transactions; cash flow projections for a two- to three-year period, with key assumptions, are included that highlight amounts that would be at risk of not materializing and management's strategies to handle such an event;
- Major risks and uncertainties as well as the risk management strategies and the potential impact of the identified risks on an organization's operating results, capital resources and liquidity;
- A section on human resources that identifies how staff is trained and management's team leaders.

The wording used in the MD&A's Cash Resources section will help an organization draft the new financial statement disclosures relating to liquidity that will be needed soon as part of FASB.

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FINANCIAL STATEMENT DISCLOSURES

Your organization's annual financial statements offer another opportunity to highlight your unique story. Consolidated financial statements present the best view of the entire enterprise, including the real estate portfolio under its control. But to emphasize the financial condition of the parent, we wrote a series of footnote disclosure samples through Strength Matters that break out the parent-only data within each footnote disclosure. These sample disclosures are also available on the Strength Matters website.

For example, the sample footnote disclosure for an affordable housing developer's consolidated notes payable begins with the notes payable owed by the parent (developer) company. Customarily, the disclosure of such notes is buried within the consolidated note payable footnote, given that the parent's notes may not be material enough to justify a separate description. By separating these notes payable from the real estate portfolio's payables, readers can learn more about the parent company's liquidity and upcoming debt service needs.

Another example is the disclosure of related party transactions, most of which are eliminated on a consolidated financial statement since the parent company's receivables from consolidated subsidiary partnerships are offset against the partnerships' payables to the parent. However, such receivables represent a source of liquidity to the parent company. Customarily, no disclosure is made regarding such related party receivables/payables, since the consolidated amount nets to zero. By including a disclosure that provides details about the parent company's related party receivables, readers are made aware of a source of liquidity that might have escaped their attention otherwise.

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NEW FASB STANDARD

In 2016, FASB issued ASU No. 2016-14 *Not-for-Profit Entities,* which will become effective for calendar year 2018 financial statements. The new standards require several modifications to existing financial statement formats, and these changes will be the subject of a future whitepaper. Several of these changes can also support telling your organization's unique story, for example:

- Enhanced disclosures will be required regarding the limits on the use of resources imposed by donors, and
- New disclosures will be required regarding how an organization manages its liquidity to meet short-term demands for cash.

These new disclosure requirements provide evidence that standard setting bodies, such as FASB, believe that the current minimum required disclosure is insufficient to educate readers about an organization's resources and obligations. The sample documents described in this paper provide additional suggestions to organizations wanting to inform readers about their past results and future capacity. A recent meeting of Strength Matters CFOs in Denver, CO, identified the need to increase the scale of each organization as a paramount concern. By telling your story with greater transparency, nonprofit affordable housing developers as a group will demonstrate forward-looking financials and therefore, should attract more capital investment.

If you have any additional questions regarding methods to share your organization's story through an MD&A, financial statement disclosures or FASB's new requirements, contact the affordable housing team at LvHJ.

S. Scott Seamands, CPA, is an audit partner at Lindquist, von Husen & Joyce LLP in San Francisco, which has served affordable housing industry developers for more than 30 years. Scott is a member of the StrengthMatters CFO Working Group and has written for Affordable Housing Finance magazine. Contact him at sseamands@lvhj.com or 415-905-5408.