Presentation of Financial Statement Disclosures – Property and Equipment

Discussion

What footnote format is the most useful to lenders and other financial statement readers for disclosing information about a not-for-profit organization's property and equipment?

GAAP Requirements

Significant Accounting Policy Disclosures

An organization reports its significant accounting policies related to property and equipment in the summary of significant accounting policies note. Policies such as depreciable lives for various classes of property and equipment, the methods used in calculating depreciation for each major class of depreciable assets, the capitalization policy, the amount of capitalized interest, the basis of valuing the assets (cost if purchased or fair value if contributed), impairment loss recognition and whether the organization has adopted a policy for implying time restrictions on contributions of long-lived assets (and cash restricted to purchasing them). Such policy disclosures are not the subject of this paper. However, additional information on property and equipment policies can be found in Strength Matters Topic 6: Preparation of the Statement of Financial Position; Topic 11: Asset Capitalization and Depreciation Policy at Corporate and Property Levels; and Topic 16: Financial Statement Disclosures.

Balances of Major Classes of Property and Equipment

GAAP requires the balances of major classes of depreciable and non-depreciable assets to be disclosed, either on the face of the statement of financial position or in the note disclosures. Property held for rental to third parties should be identified. The amount of property and equipment not held for use in operations, such as property held for sale or development in progress, is also to be identified. Additionally, accumulated depreciation, either by class of asset or in total, and depreciation expense recognized during the period must be disclosed.

Limitations on Use of Property and Equipment

Liens on property are required to be disclosed, as well as donor-imposed or legal limitations on either the use of property and equipment or on the proceeds from its disposal.

Presentation of Financial Statement Disclosures – Property and Equipment

Analysis/Input

Property Held for Rental

Affordable housing developers may hold property and equipment for various purposes. The largest balances are often the portfolio of rental properties which are detailed in the list of real estate owned that is illustrated in the sample list of affiliates disclosure (See *Strength Matters Financial Statement Disclosures – Affiliates*). If it is material, property and equipment comprising the organization's office(s) should be disclosed separately from the rental property portfolio since the organization's office property is not subject to rent and is viewed differently by lenders. This separation allows readers to identify the amount of property held for rental.

Generally the required disclosure of depreciation expense for each year appears in the statement of functional expenses or in the statement of activities and is often included in the footnote disclosure as well.

Development in Progress

Another category of property is development in progress which has not yet been placed in service. In addition to meeting the GAAP requirement to disclose the total non-depreciable property held as development in progress, financial statement users find it informative to see a detailed listing of the properties in this category, along with the amounts capitalized, expected date of completion, and the number of units (if this information is not already included in the list of real estate owned disclosed in the list of affiliates section).

A portion of development in progress may represent property that is rented while undergoing substantial rehabilitation. If the property is not taken out of service during the rehabilitation phase, such property should be included in the depreciable property section. The costs that are accumulated in a development in progress account prior to being placed in service would be included in the non-depreciable property category.

Identifying the development in progress held by the parent company directly is helpful to the reader. Note that the recommended notes payable disclosure format (See *Strength Matters Financial Statement Disclosures – Notes Payable*) segregates debt related to parent company property in a similar manner.

For a large developer, this disclosure is generally made in a table format whereas for a smaller developer, text in a paragraph format may be more appropriate.

Presentation of Financial Statement Disclosures – Property and Equipment

Property Held for Investment

Developers may be unable to utilize certain real property in the short term for a viable development because of economic or other reasons. When such property is a significant portion of the development in progress, it should be separately identified as property held for investment since the property is not undergoing any development. Such property is generally included in non-current assets and a separate note disclosure may be necessary to inform readers about the significant components of this account balance.

Property Held for Sale

Unless affordable housing developers are involved in single-family home development, it is rare to see an inventory of property held for sale. When property is held for sale it is generally treated as a current asset similar to inventory and reported separately from property and equipment. If an active market does not exist for the property held for sale it may be more appropriate to categorize it as a non-current asset. In that case, a note disclosure about the significant components of this account balance is helpful to readers.

Liens and Restrictions on Use

Property liens are generally described in the notes payable disclosure with a general comment that notes payable are secured by real property. Although some property and equipment may not be subject to a lien if there is no debt encumbering the property, the amount of such unencumbered property is generally not material enough to be separately identified.

Restrictions on use, such as affordability restrictions, are generally disclosed in the organization and nature of activities note. Whereas a disclosure of the term of affordability restrictions is often seen in the financial statements of single-property entities, a consolidated financial statement should also disclose aggregated information by stating that various loan, regulatory and other agreements dictate maximum income levels of new tenants and provide rent and other restrictions which extend through a specific year, i.e. the latest year that is specified in agreements with any of the consolidated entities.

Presentation of Financial Statement Disclosures – Property and Equipment

Sample Financial Statement Disclosures

NOTE XX - PROPERTY AND EQUIPMENT

Property and equipment consists primarily of the properties that are listed in Note 1 and are summarized as follows:

	2013	2012
Land	$117,386,721	$113,261,686
Land improvements	54,695,785	44,063,904
Buildings and improvements	878,621,078	801,842,107
Furnishings and equipment	1,455,663	1,299,118
	1,052,159,247	960,466,815
Total accumulated depreciation	(228,424,503)	(203,214,348)
Net property and equipment	$823,734,744	$757,252,467

NOTE XX - DEVELOPMENT IN PROGRESS

Development in progress is summarized as follows:

	New Units	*Rehabilitation Units*	2013	2012
ABC Associates, L.P.	-	20	$(1) -	$ 1,134,536
DEF Associates, L.P.	60	-	(1) -	11,905,531
GHI Associates, L.P.	-	74	(1) -	247,692
JKL Associates, L.P.	66	-	(1) -	15,023,695
MNO Associates, L.P.	88	-	(1) -	19,920,376
PQR Associates. L.P.	-	120	(3) 138,781	138,781
STU Village, L.P.	-	100	(1) -	1,705,655
VWX Associates, L.P.	40	-	(4) 19,126,648	6,997,776
YZ Park (2)	-	95	241,386	239,750
Other (5)	-	-	529,379	333,774
Total			$ 20,036,194	$ 57,647,566

(1) Construction was completed in 2013.

(2) Project under pre-development; owned by ABC, Inc. as of December 31, 2013 and expected to be completed in 2015.

(3) Construction schedule and completion date are not yet determined.

(4) Construction is expected to be completed in 2014.

(5) Includes various projects under pre-development that are owned by ABC, Inc.

Presentation of Financial Statement Disclosures – Property and Equipment

NOTE XX – PROPERTY HELD FOR INVESTMENT

ABC, Inc. owns 40 acres of vacant land in Visalia, California which is not currently undergoing development activity. The land is recorded at $250,000 which was its cost in 2007. Management believes that the fair value exceeds the cost.

NOTE XX – PROPERTY HELD FOR SALE

During 2007, ABC, Inc. developed 40 townhomes for sale in Modesto, California. Five have not been sold as of December 31, 2013. The cost basis of the five townhomes was $950,000. During 2009, management recognized an impairment loss of $450,000 to reduce the carrying value to the estimated fair value based on comparable sales in the Modesto area. The $500,000 balance is categorized as a long-term asset since sale of the townhomes may not occur until local economic conditions improve.

<u>Acknowledgements</u>

STRENGTH MATTERS® gratefully acknowledges the work of S. Scott Seamands from Lindquist, von Husen & Joyce LLP and the following individuals that contributed to this paper:

Allison Adduci, Vice President of Finance and Accounting, Preservation of Affordable Housing, Boston, MA
Diane Borradaile, Director of Asset Management and Underwriting Low Income Investment Fund, New York, NY
Art Fatum, Chief Financial Officer, MidPen Housing Corporation, Foster City, CA
David Keene, Director of Finance and Operations, The Neighborhood Developers, Chelsea, MA
John Maneval, Director of Lending, NeighborWorks Capital Corporation, Silver Spring, MD
Mary White Vasys, Principal, Vasys Consulting Ltd, Chicago, IL

Last Updated: October 2014

Presentation of Financial Statement Disclosures – Property and Equipment

For further information, contact info@strengthmatters.net.