

Financial Manager's Peer Support Meeting August 15, 2007

Presenters: Kay Sohl, TACS; Gary McGee, CPA (gary@garymcgee.com)

The purpose of this conference call was to discuss EITF 04-5, *Investor's Accounting for an Investment in a Limited Partnership When the Investor is the Sole General Partner and the Limited Partners Have Certain Rights*, a ruling from the Emerging Issues Task Force (EITF). The EITF is a branch of the Financial Accounting Standards Board whose mission is to improve financial reporting through the timely identification, discussion, and resolution of financial accounting issues within the framework of existing authoritative literature. The EITF has the full authority of GAAP.

This rule took effect for fiscal years beginning after December 15, 2005, meaning that fiscal years ending on December 31, 2006, June 30, 2007, and after will be affected.

EITF 04-5 says that the General Partner in a Limited Partnership is presumed to have control over the Limited Partnership regardless of the extent of their ownership interest. Therefore, the General Partner is required to consolidate the Partnership's financial statements ~~on~~ into their own financial statements unless they meet an exception. There are two exceptions:

1. Kick-out rights: If the Limited Partner can dissolve (liquidate) the limited partnership or otherwise remove the General Partner without cause, then the General Partner does not have control
2. Substantive Participating Rights: If the Limited Partner has a sufficiently large voice in partnership operations, the presumption of General Partner consolidation is overcome.

Jim asked how strict the EITF's interpretation of kick-out right is. They must be fairly clear; there can be no significant barriers. Usually kick-out rights can be acted on by a vote of one or a majority of the Limited Partners. The Limited Partner must be able to remove the General Partner without cause or liquidate the Partnership without cause. Kick-out rights and their composition is different than protective rights, which are in place to protect the Limited Partner.

How does the EITF define Substantive Participating Rights? These rights provide the Limited Partner with the ability to participate in decisions made in the normal course of business for the corporation. Examples:

- Limited Partner effectively participates in hiring, terminating and setting the work plan for the property management company
- Limited Partner must approve the corporation's budget

Appointment of the auditor is not considered a Substantive Participating Right. The rights must be written rules in an agreement, not efforts made in good faith. It is possible to change your agreements to remove or add Substantive Participating Rights or kick-out rights. Most attorneys that Gary McGee has spoken with would rather not change the kick-out rights but are sometimes more willing to recommend changing Substantive Participating Rights.

The EITF pronouncement is very detailed and helpful; people should review it if they have questions.

The goal of consolidated financial statements is to give the viewer a more complete picture of the organization's activities and financial position. If they must consolidate, nonprofits need to consider how to consolidate their financial statements without confusing funders and other stakeholders. Consolidated financial statements may include assets that the nonprofit only partially controls, or shows losses that are really attributed only to the Partnership.

Kay asked people to reflect upon whether there was anything wrong with consolidation – many people have looked at it as a problem, but does it really put the organization at a disadvantage? Patty Broker from CAPECO mentioned that they consolidate their financial statements and their Board really likes it.

Jim Richman asked what an organization should do if it and the Limited Partnership have different fiscal year ends. GAAP doesn't specifically say, but most organizations follow SEC rules on how to consolidate if the fiscal years ends are more than 3 months apart.

Robin Smith from HDC asked how difficult it is to consolidate the books of a nonprofit corporation and a for-profit corporation. It doesn't look that different, but can be confusing to people who aren't used to reading financial statements.

Patty said that they view their consolidated statements as a chapter in a book. In one "chapter" is the consolidated statements. In others are explanations of what is happening with the organization's different programs.

When an organization consolidates, a lot can be done in the net assets portion of the balance sheet to convey how much control the nonprofit has over the funds.

Ann from Northwest Housing Alternatives asked what happens if a nonprofit has Substantive Participating Rights in some Limited Partnerships and does not in others. Can the nonprofit choose to consolidate all these Limited Partnerships in its financial statements? No – the nonprofit must consolidate only Limited Partnerships where it has control. It is possible to "combine," rather than consolidate, the financial statements.

Kay asked if anyone was considering changing their organization's fiscal year to align with the Partnership's fiscal year. One organization said they will do that if they decide to consolidate. They would change their whole organization to a calendar year. Changing fiscal years is a lot of work and one participant said they were not sure if HUD would allow you to change the fiscal year of your project.

Has anyone received input from a bank or a tax credit syndicator on what would happen if an organization was supposed to consolidate and did not? No answer.

One of the problems with consolidating Partnerships and organizations that have different fiscal years: if an auditor only sees a percentage of the total year for a project, can they really get an accurate picture of the organization's financial standing?