Management’s Discussion and Analysis: Best Practices for Not-for-Profit Entities
Recognition

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Preface

Management’s discussion and analysis (MD&A) is a narrative explanation, from management’s perspective, of how an organization has performed and is positioned to perform both financially and in the furtherance of its mission.

The purpose of the MD&A is to increase the reader’s understanding of the NFP’s financial health, stewardship, and future prospects.

An MD&A is not required for not-for-profit entities (NFPs), but it can provide valuable information to current and prospective donors, volunteers, creditors, regulators, and various other stakeholders. Strategic context, explanatory insights, and nonfinancial results are just a few of the valuable items an MD&A offers.

For donors, the nonfinancial elements of an MD&A may be particularly important. Donors give to support a mission they care about. While the financial statements may identify how much an NFP is spending on mission-related programs, they do not indicate how that spending translates into outcomes. This makes the MD&A an important companion to the financial statements.

Many smaller NFPs understand the value of an MD&A to their constituents but struggle with how to prepare one. FASB encourages NFPs to provide nonfinancial information about programs, outputs, and results outside of the financial statements but does not require or provide a framework for such a document. Other MD&A-type frameworks are available, but they are not specific to not-for-profits.

Thus, the objective of this guide is two-fold:

- To provide a practical, principles-based approach to preparing an MD&A specifically for NFPs.
- To provide general tips and best practices that enable NFPs to produce an MD&A efficiently, while ensuring that it is useful to their stakeholders.

We hope you find it useful, whether you are just getting started or looking to improve your MD&A process or deliverable, and we welcome your feedback at nfpsection@aicpa.org.

Additional information and resources are available at aicpa.org/NFP.
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Executive Summary

Management’s discussion and analysis (MD&A) is a narrative explanation, from management’s perspective, of how the organization has performed both financially and in the furtherance of its mission. It complements the financial statements, setting the strategic context for readers’ review while promoting transparency, and enhances readers’ understanding of the organization’s financial condition and changes therein, stewardship, and future prospects.

An MD&A is not required of NFPs, but it can provide valuable information about the NFP’s financial and nonfinancial performance. There is no prescribed format or content for an MD&A. It doesn’t have to be lengthy or overly detailed. An MD&A should be written clearly and concisely and focus on the aspects that are most important to the NFP’s mission and audience.

An NFP’s MD&A should be developed based on the following core principles upon which this guide was developed:

- Enable readers to see the NFP through the eyes of management
- Augment the financial statement information
- Focus on information that would influence readers’ decision-making
- Include future-oriented insights

Recognizing that not-for-profits and their stakeholders’ needs will vary, this guide presents the following high-level framework that all NFPs can use to prepare an MD&A:

Plan

Taking the time to plan the development of your MD&A will promote efficiency in the process and effectiveness in delivery. This guide discusses the following key steps in the planning process:

- Assemble your team
- Define your purpose
- Determine your structure and format

Build

After you have completed the necessary planning, you can begin creating the content of your MD&A. This guide purposely does not provide a detailed template or checklist for content, but instead offers the following elements to consider including as you see fit for your readers:

- Mission and strategy
- Analysis of key financial results and mission-related impacts
- Risks and opportunities
- Outlook
Review

Once you’ve prepared a draft of your MD&A, who should review it? What should they look for? This guide suggests the following reviewers and notes some items they should consider when they review:

- Your external auditor
- Your board and audit committee
- Your senior leadership representative
- Your legal counsel
- Your chief communication officer or team

In addition, MD&A preparers should consider the following best practices to get the most from their efforts:

- Know your audience
- Use plain English
- Keep the discussion at a high level
- Take the opportunity to discuss nonfinancial results
- Start early
- Be careful with forward-looking information
- Ensure consistency with themes of other reports
- Change the content every year
- Focus on your purpose for producing it

Illustrative examples and additional resources are provided in the Appendix.
MD&A, Defined

Management’s discussion and analysis (MD&A) is a narrative explanation, from management’s perspective, of how the organization has performed both financially and in the furtherance of its mission. It complements the financial statements, setting the strategic context for readers’ review while promoting transparency, and enhances readers’ understanding of the organization’s financial condition and changes therein, stewardship, and future prospects.

While an MD&A is not required of NFPs, it can provide valuable information about the NFP’s financial and nonfinancial performance. It is a powerful way for management to communicate in plain English:

- How the NFP used its resources to fulfill its mission
- How readers can best navigate the sometimes-complex financial statements and identify the areas that are key to the NFP’s success
- How the NFP is positioned for the future

There is no prescribed format or content for an MD&A. Some NFPs include their financial statements and an MD&A as part of their annual report. Others present a financial report that is less comprehensive than an annual report. Still others provide a financial overview that highlights specific aspects of their results for the period. It’s important to keep in mind that an MD&A doesn’t have to be lengthy or overly detailed. It can be relatively short and focus on the elements that would affect a reader’s decision making.
**MD&A Core Principles**

To fulfill its purpose of increasing the reader’s understanding of the NFP’s financial health, stewardship, and future prospects, the MD&A should be developed based on the following core principles:

**Enable readers to see the NFP through the eyes of management**

Management’s perspective is one of the primary aspects that makes the MD&A so valuable for financial statement users who are not necessarily privy to the strategy behind the NFP’s activities. This knowledge provides useful context when viewing and interpreting results. An MD&A is a valuable opportunity for management to provide readers with a roadmap for understanding the financial statements and disclosures, insightful answers to common and potential questions about financial and nonfinancial performance metrics, and strategic context for their own analyses.

**Augment the financial statement information**

An MD&A serves as a valuable companion to the financial statements by explaining the financial performance—whether positive, negative, or neutral—and how those results might affect future performance. An MD&A may also discuss nonfinancial results, include industry benchmarks, and draw connections between quantitative results, strategic initiatives, and key performance drivers.

**Focus on information that would influence readers’ decision making**

An MD&A need not analyze every financial statement line item. Instead, it should focus on the most important information, highlighting areas where management wants readers to focus and ensuring that the information presented is streamlined to include primarily that which could affect readers’ decision making.

**Include future-oriented insights**

An MD&A offers insights that look at past performance in the context of future prospects and results. While NFPs should exercise caution when providing forward-looking information, readers obtain significant value from knowing management’s perspective on how current conditions and results may affect future activities and performance.
MD&A Framework

If your NFP has never prepared an MD&A, it can be hard to know where to start. The following framework is intended to simplify the process and help you dive right in.

Step 1: Plan.

Taking the time to plan the development of your MD&A will promote efficiency in the process and effectiveness in the delivery. Be sure to start early—well ahead of period end—and consider the following key steps:

**Assemble Your Team**

To find the right core group for the job, make sure to get representation from leadership and every key area of the organization; then consider the teams they will need to interview and work with to gather the necessary information (e.g., HR, legal, program services, etc.). Also, consider non-staff support. Are there key stakeholders such as board members who could serve as resources to the team, both in content development and validation? Remember that MD&A looks at the NFP through the eyes of management.

**Define Your Purpose**

Once assembled, the MD&A team should clearly define and articulate the purpose of this effort. Take the time to consider the specific outcomes you are hoping to achieve. Is there an area of the financial statements that needs an explanation beyond the required footnote disclosures? Did your NFP achieve significant mission-related outcomes during the period that you want to make sure receive proper attention? Do you want to build trust with your readers and demonstrate management’s capabilities?

If no such specific goals apply, then review the core principles in this guide, and consider the following:

- Who are your readers?
- What do they need to understand about the results of operations and prospects for the future?
- What questions might they have for your senior leadership after reviewing your financial statements and footnotes?

**Auditing Consideration**

Content you include in your MD&A or annual report may be subject to additional procedures by your auditor. Having a conversation with your auditor during the planning stage will help you to understand these requirements.
Defining your purpose for preparing an MD&A will lay a solid foundation for the effort and provide a filter through which you can vet content as you compile it. If this is your first time preparing an MD&A or there aren’t specific goals you’re trying to achieve with it, consider starting broad, perhaps with something like this:

_The purpose of our MD&A is to increase our readers’ understanding of [NFP]’s financial health, stewardship, and future prospects._

_Determine Your Structure and Format_

Will your MD&A be a stand-alone document or part of the annual report? Could it replace the annual report? Will it be formatted as a report or a letter? Make sure you address consistency and comparability, including cohesiveness in theme, with other information you publish.

_Step 2: Build._

In Step 2, you will determine your content. Deciding what to include can be challenging, so use the information that follows and the examples in the Appendix for ideas. The MD&A content elements presented in this guide are not intended to be prescriptive or stringent.

At the most basic level, the purpose for presenting an MD&A is to show stakeholders how management views the organization. As such, preparers should consider a wide range of management perspectives, as well as insights from the NFP’s internal operating functions and external reporting teams. You will want to include the elements that best depict the NFP’s strategy and future prospects. This is an opportunity to showcase your vision and strategic focus in a manner that connects with your stakeholders.

There is great flexibility in the way results of operations can be explained, as well as in the presentation of key metrics and trends that offer transparency into the organization’s strategic management rubric. From management’s perspective, what are the key highlights from the NFP’s financial statements this period? What events and circumstances led to those results, and how does management anticipate they will affect future performance?

The following elements align with the MD&A core principles. The details, order, and structure, while logical and acceptable, are not prescriptive but are intended to help NFPs as a starting point. Brief overviews of each element are provided here. Refer to the Appendix for illustrative examples.
Introduction

There are a variety of ways to introduce an MD&A. Some NFPs include no introduction at all, some include just a paragraph without a subheading, and others use subheadings such as “Overview” and “Introduction.” Content and length vary as well. Be sure to think about your audience, their needs and expectations, and the content you plan to include in your MD&A.

Consider starting the MD&A with an overview that covers the following elements:

- **Mission, Business Overview, and Strategy** – Briefly state the organization’s mission and how it is structured to achieve that mission, including major programs and segments. You might also give a high-level overview of your strategic objectives.
- **Key Performance Indicators (KPIs)** – Offer context for the results of operations you plan to discuss by stating the KPIs management monitors to gauge the NFPs progress toward its goals.

Analysis of Key Financial Results and Mission-Related Impacts

While the financial statements and notes disclose the results of your NFP’s operations and financial position, the MD&A is your chance to offer qualitative insights that explain the results in your own words—that is, from management’s perspective, what happened during the period that led to the results you’re reporting. The “why” behind the numbers is not always apparent from the footnote disclosures, so this is where you can provide context to fill in the gaps.

Your discussion and analysis will typically include an overview of your NFP’s financial performance and mission-related outcomes, followed by additional details and analysis for selected areas. There is a careful balance to strike between the need to eliminate unanswered questions and avoiding information overload for your readers. Your inclusion or exclusion of certain information should be intentional and rational. Emphasize what and how management thinks about improving performance toward goals and targets and discuss the implications of related actions on the NFPs resources.

As you consider what to include, apply the core principles in this guide, as well as the following:

- **Focus on results that are material to the NFP’s ability to fulfill its mission.** It is not necessary to discuss every metric or financial statement line item. The MD&A, much like an executive summary in a formal report, allows you to establish the framework through which your readers will evaluate and analyze the financial statements and disclosures.
Focus on qualitative discussions. The MD&A may include certain quantitative metrics, but they should add to, not repeat, what is already in the financial statements. Assume that readers will perform their own analyses and draw their own conclusions, but you have an opportunity through the MD&A to increase transparency and provide explanations for certain results.

Focus on strategic information. The MD&A should offer insight about why the NFP achieved or did not achieve its strategic goals and how those circumstances could affect the NFP’s ability to achieve its objectives and mission-related impacts.

Sprinkling in key financial statement excerpts, charts, and graphs may be helpful in rounding out your MD&A. If you have historical trends, peer comparisons, or industry benchmark data, you may wish to include some of those as well to indicate how your organization has performed in relation to others. But take care not to drill down into every metric; just stick to those that materially affected the fiscal period and are most important to your readers. Remember, the MD&A should help stakeholders gain visibility into the macro-level insights so that they have context surrounding the major events and strategic decisions that significantly influenced the NFP’s financial results.

Financial highlights could be organized in a variety of ways, including but not limited to the following:

- By financial statement
- By financial statement item or metric (e.g., income, expenses, liquidity, and cash flows)
- By major program
- By strategic objective

Nonfinancial highlights could be organized by strategic objective, by constituent or beneficiary group, or by program, just to name a few examples. Refer to the Appendix for illustrative examples.

Risks and Opportunities

The MD&A gives you an opportunity to increase transparency around the future challenges your NFP is facing. You may wish to highlight key risks for the NFP as a whole, as well as for your major programs, and any plans to mitigate them, along with key opportunities and how you plan to take advantage of those. The MD&A is not the place to present every single risk; instead focus only on those that are mission-critical and align with your strategic objectives.
Risks and opportunities discussions are often found in annual reports. If your NFP produces an annual report, you will want to consider where there may be crossover and how the MD&A best fits into the total package of annual financial reporting that you share with your stakeholders. Consistency in messaging is critical, and you’ll want to minimize duplication of effort for internal efficiency and reader friendliness.

Outlook

Consider wrapping up your MD&A with a concluding statement that summarizes management’s view of the future prospects of the organization, considering the historical results, trends, risks, and opportunities previously discussed. Explain critical internal and external performance drivers that affect management’s ability to deploy the business strategy and achieve the NFP’s goals. Tie everything together with parting thoughts on how the NFP is positioned to perform in the future.

Step 3: Review.

Once you’ve prepared a draft of your MD&A, who should review it? What should they look for? This, of course, is a critical step that you won’t want to overlook. Consider enlisting the following reviews:

- **Your external auditor** – Whether or not your MD&A accompanies the audited financial statements, it is a good idea to have your auditor read it. Content you include in your MD&A or annual report may be subject to additional procedures by your auditor. Having a conversation with your auditor during the planning stage will help you to understand these requirements.

- **Your board and audit committee** – The board and audit committee or audit committee chair should look for any information in the MD&A that could be misleading to the users of the financial statements or is inconsistent with organizational policies, the audited financial statements, and any reports that have been provided to the board. Board members also are well positioned to assess the effectiveness of the MD&A, including completeness, usability, and transparency.

- **Your senior leadership representative** – If the MD&A was not prepared by the chief financial officer, he or she should look for any inconsistencies in figures between the MD&A and the audited financial statements, as well as any information that is inconsistent with organizational policies and procedures or information previously published. If your CFO prepared the MD&A, then this review should be performed by your CEO or other senior executive. When reviewing, the senior-level reviewer should also consider what questions are often asked by your stakeholders and whether those have been adequately addressed in your MD&A.
• **Your legal counsel** – Consider having your legal counsel review your MD&A for consistency with the financial statements, especially commitments, contingencies, and risks. If there is discussion of legal proceedings in the MD&A, your legal counsel can determine if the information included is appropriate for public disclosure. Conversely, if your organization has ongoing legal issues that have not been discussed in the MD&A, your legal counsel may bring that to your attention for consideration. They also should review any forward-looking information to make sure you have not included predictions or forecasts that could result in legal action if they are not achieved.

• **Your chief communication officer or team** – Involve your communications staff as appropriate for your organization. They may review the MD&A for consistency with applicable communications policies as well as with information previously published. They can also assess understandability from a nonfinancial user’s perspective.
Best Practices

Following are some best practices for MD&A preparation.

Know your audience

Who are the main users of the financial statements and what are they interested in understanding about your NFP? The answer to this question should help you to focus on the results that you want to discuss in greater detail. For example, a performing arts organization that can only survive with the support of donors may want to highlight its sources of revenues and how those are used to fund its mission. This will show donors that the organization wouldn’t be able to fulfill its mission without their continued support.

In addition to donors, creditors and regulators also use the financial statements to assess your NFP’s compliance, financial stewardship, and sustainability. The MD&A is a platform to explain the factors driving the results of operations and, when they fall short of goals or expectations, how the organization intends to address any issues.

Financially savvy readers will benefit from the contextual nature of an MD&A, before they dive into their own analysis of the financial statement details. For less experienced readers, an MD&A will point to and explain key highlights and tie those to the strategic goals of the NFP.

Use plain English

As you take advantage of this opportunity to tell more of your NFP’s story, it is important not to use a lot of industry jargon or acronyms that your audience may not understand. Also, when possible, use visual elements such as charts and graphs to facilitate the reader’s understanding of your analyses. Consider each element of content, and ask yourself: Can it be simplified? Can we explain it in a more familiar way?

While it might be reasonable to assume a basic level of financial acumen, it is best not to assume that readers of the MD&A will have technical accounting knowledge. A good approach might be to 1) think of the MD&A as a conversation with your NFP’s current stakeholders, wherein you anticipate the questions they might reasonably ask regarding achievements and plans for continued performance; and 2) think of potential questions regarding mission and impact that might be asked by prospective donors and supporters.
Focus on your purpose

Having defined the purpose for your MD&A, you can use that as the filter for its content. As you compile and edit the content, eliminate anything that doesn’t add value for your readers. Make sure every element contributes to the core purpose of the MD&A.

Discuss and analyze

This may seem obvious, but it is important to make sure your MD&A does not simply repeat the information in the financial statements. In accordance with the core principles discussed earlier in this guide, the MD&A should provide additional insight and informative value beyond what the reader could obtain by just reading the financial statements and disclosures. For example, while the financial statements report year-over-year changes, the MD&A can explain what events and circumstances caused those changes and what management plans to do to take advantage of opportunities and mitigate risks. It is also a best practice to include peer comparisons and industry benchmarks when available to provide valuable context for readers.

Keep it high level

It’s not necessary to explain every line item in your financial statements. Focus on those that are most important to your mission, that is, your key performance drivers and key performance indicators. Keep the discussion brief and offer strategic context to the material operating metrics. For example, a college may highlight the fact that revenue from tuition and fees was up 5% in the current year because it attracted more students to its engineering program due to its international recruiting initiatives.

Talk about nonfinancial results

The financial statements and disclosures alone are not a platform for communicating programmatic accomplishments. FASB encourages, but does not require, presentation of information about an NFP’s major programs (or segments), and related non-monetary information about program inputs, outputs, and results. FASB acknowledges, however, that such information is generally feasible only outside the basic financial statements.

Program service accomplishments are presented in Part III of IRS Form 990 Part III (Statement of Program Service Accomplishments), and they may appear in annual reports, which are often published separately from the audited financial statements.

The MD&A serves a dual purpose of discussing the NFP’s financial results and programmatic successes. For example, a soup kitchen might discuss the reasons for its year-over-year increase in operating reserves as well as the number of meals it served compared to previous
years or how it performed against its plan for the year. It might also discuss both the financial and nonfinancial impacts of certain successes, such as the fact that they were able to serve healthier meals at a lower cost per meal.

As a complement to the financial statements, the MD&A is a powerful vehicle for an NFP to tell the rest of its story using information that, through transparency and authenticity, helps stakeholders better understand the organization’s sustainability, the quality of its management, and its capability to successfully steward limited resources in furtherance of the NFP’s mission.

Maintain consistent themes

The content of the MD&A should reflect messaging that is consistent with other information provided to stakeholders across the NFP’s communications platform, including management’s discussion within annual reports, donor literature, newsletters, and strategic web content. The MD&A should harmonize key messages that offer readers a strategic glimpse into the organization.

Be careful with forward-looking information

Follow these tips to strike the right balance with forward-looking information:

- Avoid making financial forecasts or predictions.
- Limit forward-looking statements to a reasonable time frame.
- Explain your rationale.
- Disclose underlying assumptions and risks.
- Consider the need for a disclaimer.
- Obtain appropriate reviews.

Future-orientation is a critical part of the value an MD&A provides to readers. Yet management should be aware of the legal ramifications of bringing out the crystal ball. There is a balance to strike; you don’t want to be too open or too conservative. Unlike public companies, there is no safe harbor for forward-looking statements made in an NFP’s MD&A. Therefore, it’s important not to make financial forecasts or other predictive statements. On the other hand, if you’re not providing insight beyond what readers can obtain by simply reading the financial statements, then you aren’t making the best use of your efforts.

Management can discuss potential effects of performance drivers and trends without predicting numerical outcomes. As indicated in step 2 of the MD&A framework, you can also discuss possible risks that the NFP faces in the future and how management plans to address them, as well as their potential impact on management’s ability to deploy its strategy and achieve related goals.
When making statements about key performance drivers like, “our [people, volunteers, stakeholder relationships, etc.] are our greatest asset,” be sure you explain how that determination was made and why management believes the driver will benefit the organization in the future.

It is also important to limit forward-looking information to a period during which reasonable supporting estimates and assumptions can be made (and, where appropriate, disclosed) and discuss relevant risks and uncertainties that could affect their accuracy. Some NFPs choose to include a cautionary statement, such as the following:

>Certain discussions in this document may include forward-looking statements (typically, statements that include “believe,” “expect,” “estimate,” “plan,” “intend,” “may,” etc.) that involve known and unknown risks and uncertainties inherent in our operations. Actions, results, and trends may differ materially from those discussed herein. Specific factors that might cause such differences include…

Awareness of any applicable legal and regulatory requirements and careful review by appropriate personnel also are critical when incorporating forward-looking statements. Forward-looking information is inherently uncertain as it is based on assumptions and estimates. However, with adequate disclosure and review, it may be more helpful for readers to have this information than not.

**Change it up**

Steer clear of boilerplate and instead, take the opportunity to connect with your readers through this valuable communication channel. If you are following the best practices of keeping your MD&A brief and high-level, then it shouldn’t be too onerous to write something new each year. Readers will value your authenticity. Think creatively. How can you approach the process differently? How can you tell your story more effectively? How can you be more transparent?

**Start early**

If you’ve never prepared an MD&A before, it’s hard to know exactly how long it will take. Give your team plenty of lead time by starting well ahead of period end. Rushing to put something together at the last minute could diminish the value of your efforts. Allow enough time to follow the process outlined in this guide and document lessons learned along the way. A common mistake among MD&A preparers is to overemphasize the content development step and skimp on planning and review time. Planning is critical for efficiency, and review is critical for effectiveness. The first time through will be the most time-consuming, so know that upfront but expect that you will tweak your process and deliverable each year as you become more experienced in putting an MD&A together.
Conclusion

An NFP’s stakeholders will benefit from having a well written and informative MD&A because it provides clarity and insight into the organization’s financial performance—both successes and shortfalls—and its mission-related impacts. It is also a critical communication channel for sharing management’s vision for the future and developing trust with readers through transparent, authentic discussion.

The term “management’s discussion” is important as this is the perspective from which the report should be written, thinking of the conversation management would want to have with current and potential stakeholders. Following best practices, the MD&A should be brief and written in plain English.

The primary function of the MD&A is to enhance the reader’s understanding of the NFP’s financial health, stewardship, and future prospects. Take the time to make your MD&A strategically purposeful, easy to understand, and effective and relevant for your organization’s audiences.

While not required for NFPs, an MD&A will enhance your stakeholders’ understanding of your financial performance and mission impact.

Use this guide as a practical tool for getting started or optimizing your process and deliverable.
Appendix

Illustrative Examples

In the following pages, you will find MD&A excerpts from various types of NFPs that are already providing valuable insights into their strategic performance, direction, and sustainability in a transparent, authentic, and effective manner. These examples illustrate the application of principles and best practices set forth in this guide. We encourage you to review them to see what other NFPs are doing and get a feel for the wide variety MD&As can have in form and content.
Letter from the Chief Financial Officer [Excerpts]

While overall revenue declined slightly for the year, [Organization’s] commitment to tackling the root causes of poverty reached new levels, fueled by the successful conclusion of our capital campaign. With this campaign, we exceeded our goal of helping 20 million people thanks to the generosity of donors who committed more than $500 million over the last five years. These funds are transforming the lives of children and families living in [Organization] communities by providing clean water, economic development, and other essential interventions.

20X2 Financial Results

Private Cash Revenue. Revenue from private cash donations declined 5% in 20X2 to $571 million. A drop in the number of child sponsors beginning in 20X1 lowered donations for our child sponsorship program through 20X2. As we start fiscal 20X3, the trend for cash contributions has improved, indicating a stronger outlook for donations in the current year.

Grants and Gifts In Kind. Grants from the U.S. government declined 12% in 20X2 to $172 million, while gift-in-kind revenue rose 10% to $255 million. These important revenue streams add valuable resources to the communities of [Organization] sponsored children. However, they tend to be opportunistic, and will fluctuate based on government funding decisions and corporate inventory levels. In the case of grants, revenue recognition is also affected by the pace at which programs can be implemented in the field.

Program Services. Funding to [Organization] affiliates around the world, as well as U.S. ministry partners, was $839 million in 20X2, representing 85% of operating revenue. We believe the most important measure of a charity is its effectiveness in accomplishing its mission. We continually monitor and evaluate [Organization’s] programs to determine how the lives of children are being improved, using measures of child well-being such as access to clean water, health and nutrition levels, and educational achievement.

Fundraising & Administrative Expenses. Fundraising, management, and general expenses (sometimes called overhead expenses) were reduced by $3 million, or 2%, in 20X2. Our overhead rate (overhead expenses as a percent of operating revenue) remained steady at 15%.

Change in Net Assets (Surplus). Total net assets from operating activities improved $9 million during the year. [Organization’s] objective for financial liquidity and reserves is to operate in a prudent range of stability, while recognizing the imperative of distributing maximum funds to mission as quickly as possible. [Organization] remains financially strong, with sufficient liquid assets to discharge ongoing ministry commitments and other obligations.
Chairman’s Report [Excerpts]

The [Opera’s] 20X2 season featured an extraordinary number of artistic highlights, while the company continued to address the significant financial challenges of grand opera. The [Opera] presented six new productions during the 20X2 season. Along with four revivals, all six new productions were presented in movie theaters around the world as part of the [Opera’s] Live in HD series, which earned $26.2 million. Combined earned revenue for the [Opera] (Live in HD and box office) totaled $117 million. Total box office revenue for the season was 73.2%. Several productions sold out their runs.

While enjoying great artistic successes, the company faced challenging economic hurdles, ending with a deficit after five years of break-even or close to break-even results. However, contract negotiations with the [Opera’s] unions, still in process at the end of the fiscal year, resulted in cost reductions to help ensure a more sustainable financial model for the future.

Finally, this was a year in which we embarked on a difficult but necessary effort to reduce the [Opera’s] expenses and increase its endowment. Thanks to the cooperation of so many, our efforts have so far been successful. We remain committed to working together and finding new ways to protect and strengthen the financial security of this great company. With a more sustainable financial future, we can ensure the [Opera’s] unparalleled artistry is enjoyed around the world for decades to come.

[Chairman]
Management's Discussion and Analysis [Excerpts]

Future Concerns and Issues

The [Center] is an outstanding institution, but it will achieve even greater impact on public ideas as it sharpens its focus and increases its relevance over the next three years. At a time of divisive debates among people of different political, religious, and national backgrounds, the [Center] stands as a beacon to reasoned dialogue and balanced, independent research that can bridge these divides and bring credible research and original ideas to vital issues of public policy.

The [Center] maintains an active strategic plan, and is currently engaged in the following strategic goals to help improve its future:

a. Making significant efforts to ensure that there are clear synergies between fellows and scholars appointed to the [Center] and the [Center’s] ongoing programmatic work. In addition, we have given far greater attention to recruiting and selecting fellows and scholars whose work will be accessible to both the general public and to targeted policy audiences, and we actively encourage them to engage in public dialogue and outreach to those who can use their findings.

b. Highlighting the [Center’s] excellence embodied in the work of its programs, which touch on every region of the world and several of the most critical global issues. We will make even more significant strides to ensure that programs are more focused and targeted in their research; developed a small number of cross-cutting issues that build on common strengths; created a system for tracking and assessing program impact.

c. Giving priority to public outreach. We have worked to strengthen the alignment between our programs and the residential scholars significantly and to reach a broader audience, including careful targeting of key policy makers and opinion leaders. These efforts include a redesign of the [Center’s] website; more effective use of social media; enhancement of our program publications; and consistent branding of all products. We have transitioned most of our publications into digital format both to save money and to be more effective in delivering them to key target audiences.

d. Ensuring the financial sustainability of the [Center] by expanding current fundraising strategies, and through innovative outreach strategies attracting new sources of funding both nationally and internationally. We are expanding our pool of creative partnerships with interested individuals, organizations, and foundations.
e. Improving the [Center’s] human capital by strengthening recruitment of the most qualified staff possible, developing career paths that provide opportunities for growth, ensuring the necessary training for optimal job performance, and reinforcing the performance evaluation systems.

The [Center] also faces constant wide-ranging and challenging issues that include:

a. obtaining foundation and other private funding to ensure its ability to fund activities and programming at a time of prolonged economic recovery and continued global economic uncertainty;

b. achieving a sustainable balance between not overloading the [Center’s] small administrative staff and space capacity, while providing adequate and necessary infrastructure and support services that uphold all activities of the [Center]; and

c. while progress has been made over recent years, the institution remains too dependent on a concentrated core of staff and scholars and lacks a deep bench. Succession planning has been challenging and there are few opportunities for advancement for younger staff. Many staff also struggle with the need to balance programming and their own scholarship in the field.

Organizations such as the [Center] cannot be complacent: we either move forward in our agenda, mission and purpose, or we quickly become less relevant. The [Center] can – and will – continue evolving rapidly over the next few years to respond to changing needs for quality non-partisan research and dialogue that can directly participate in the most important policy discussions shaping the future of the United States and the global community. This is consonant with our mission, and since inception, the [Center] has admirably accepted the challenge.
The following example illustrates the provision of strategic context around results of operations the challenges the University will need to manage for sustainability and future growth.

Message from the Vice President for Finance and Chief Financial Officer

[Excerpts]

Strong Financial Results

For the year ending June 30, 20X2, in large part due to the recognition of revenue for the extraordinary pledge from [Donor] for the construction of two new residential colleges, [University] generated a surplus of $194 million from operations under generally accepted accounting principles. On a “Management View” basis – the way [University] looks at financial information for internal discussion and decision-making purposes – [University] generated a surplus of $17 million from operations. Without the extraordinary item related to the residential colleges, the fiscal year 20X2 operating surplus from both perspectives was in line with last year’s results.

[University’s] operations remain strong thanks to prudent financial management practices and the generous support from alumni and friends that have allowed [University] to carry out its mission of teaching and research with excellence for over three centuries.

Net assets finished the year at $27.4 billion, an increase of $1.6 billion or 6.1% over the prior year primarily due to the 11.5% investment return generated from the [University] Endowment. [University’s] balance sheet remains strong, providing a stable platform from which to carry out the varied and important mission it supports.

An Accessible and Affordable Education

For over fifty years [University] has accepted students without regard to their financial need and has met the full demonstrated need of every admitted student. [University] families whose gross income is less than $65,000 (with typical assets) are not expected to make a contribution towards the cost of their child’s [University] education. The average cost of attendance for a [University] student on financial aid was $17,328 per year in fiscal year 20X2 or approximately 27% of the “sticker price”—an amount lower in inflation-adjusted terms than a decade ago. Only 17% of [University] students chose to take out a loan during their undergraduate careers, and the average loan amount upon graduation was less than $16,000.

This policy of need-blind admissions has been extraordinarily successful as demonstrated by [University’s] diverse and talented students and alumni. This has made [University] accessible and affordable even though in financial terms it means only a small portion of [University’s] annual revenue comes from tuition, room, and board net of financial aid.
If a relatively small proportion of revenue comes from tuition, how does [University] finance the cost of education – while keeping net tuition and student debt at comparatively low levels? The answer is generous gifts from donors to support financial aid – and the [University] Endowment.

**Funding Teaching and Research for Current and Future Generations**

The [University] Endowment provides over $1 billion in revenue each year (32% of total revenue in 20X2) the single largest source of funding for [University]. The [University] Endowment provides important funding to every school and department on campus, supporting the widest array of activities: financial aid, faculty salaries, residential colleges, classrooms, laboratories, lab supplies, journals, artwork, health care and retirement benefits, utilities, administrative support, and many other costs of teaching and research.

[University’s] policy for spending from the endowment balances the needs of current and future students and scholars. It provides a stable flow of income to the current operating budget; and it protects the real value of the endowment over time so that future generations of scholars can benefit from a similar stable flow of income. [University] is committed to being a responsible steward of this important asset, and that means neither over- nor under-spending.

In order to provide that support the endowment must generate sufficient investment returns to replace both the $1+ billion spent each year and also enough to keep pace with inflation. That requires an investment return of roughly 8–9% on average at current inflation rates just to fund the same level of financial aid, teaching, and research as during the preceding year. That type of return would be the envy of most investors. Fortunately, [University’s] Investment Office has been able to meet and even exceed that level over long periods of time. That is why [University] was able to spend such a large amount from the endowment to pay for teaching and research in fiscal year 20X2.

[University] is fortunate to have such a successful and sizeable endowment, and we are grateful to our generous alumni and other supporters who entrust us with these precious resources. They allow [University] to spend a generous amount each year while requiring prudent management to assure funding is available for future-generations’ teaching and research.

**Looking Ahead**

[University] had a successful year academically and financially thanks to the excellence that surrounds us – our faculty, students, staff, alumni, donors, the City of [City], and other members of the [University] community. Looking ahead, the external financial environment poses substantial challenges that [University] will need to manage. The funding for health care and research in the United States remains under pressure, and [University] will need to adapt since these are the two largest revenue sources after the endowment. Even so, as [University] President stated, “We need to open up the financial space necessary to do the things we want to do — space so that we can pursue the new initiatives that will propel [University] forward.”
Behind the Numbers [Excerpts]

Organizational Stability

In FY20X1, [Charity] grew its unrestricted operating reserves to $5 million (6 months of operating reserves) after two years of surplus revenue. These reserves allow us to move confidently into FY20X2 with an annual budget of $20.7 million, a 21% increase from FY20X1. Revenues increased 4% from a diversified portfolio of donors. Increased funding in FY20X1 is a direct result of greater investment in our Business Development team, clarity of our programmatic goals, and demonstrated impact in the field. Other investments in FY20X1 include the following:

- Strengthening leadership with a new CEO ([Name]) and two new country directors [Name] ([Country]) and [Name] ([Country]).
- Enhancing our brand through commercial partnerships with [Partner], [Partner], and [Partner]
- Installing financial planning software to better manage projections in revenue, expense and cash
- Investing in the human resources department in order to create a people-centered organization poised for growth

Other areas to pay attention to as we grow:

- Continuing to invest in business infrastructure to enhance global IT as well as collaborative communication tools for our global team
- Mitigating for the impacts of increased global instability, both natural and man-made, as well as operational risks, through Enterprise Risk Management
- Securing more flexible, multi-year, unrestricted and/or full-cost recovery funding partners
- Focusing on acquiring and retaining key personnel who can support the advancement of our mission, and investing in our employees
- Maintaining the highest standards of practice in accountability and transparency
Management Discussion and Analysis of Financial Condition and Results of Operations [Excerpts]

Overview

[NFP] is a [State] not-for-profit corporation exempt from federal and state income taxes. [NFP] operates 39 hospitals in [State 1], [State 2], and [State 3] and provides a variety of health care, education, and other benefits to the communities in which it operates. Health care services include inpatient, outpatient, sub-acute, and home health care services, as well as physician services through a medical foundation and affiliated medical groups.

Results of Operations

Six Months Ended December 31, 20X2 and 20X1

For the six-month period ended December 31, 20X2, [NFP] recorded an operating gain of $338.3 million compared to $164.9 million for the same period in the prior year. The results of operations for the six-month period ended December 31, 20X2, are primarily related to:

- Related to the [State] provider fee programs, [NFP] recognized $870.2 million in net patient revenue and $429.6 million in purchased services and other for a net favorable impact of $440.6 million, which was $159.7 million higher than the net provider fee income of $280.9 million recognized during the same period in the prior year. Amounts recognized include $217.1 million of net income related to January through June 20X2.
- Net patient and premium revenues increased $646.5 million, or 10.1%, over the same period in the prior year. Excluding provider fee program revenues, net patient and premium revenues increased $369.1 million, or 6.4%, primarily due to higher volumes associated with acute care activities, physician organizations and consolidated joint ventures, rate increases, and improvements in billing and collections, partially offset by a deterioration in payor mix. Provision for bad debts on uncollectible accounts decreased $28.7 million, or 9.8%, with provision for bad debts on uncollectible accounts as a percentage of gross revenues decreasing to 0.9% from 1.1% for the six-month periods ended December 31, 20X2 and 20X1, respectively.
- Hospital-only net patient and premium revenue per adjusted admission, excluding the impact of the provider fee programs, increased 3.6% compared to the same period in the prior year for the reasons discussed previously. Adjusted admissions increased 2.1% compared to the same period in the prior year.
Revenue from health-related activities, net, decreased $11.9 million over the same period in the prior year, primarily due to a loss of $6.9 million recorded during the period related to the investment in [Plan] compared to a loss of $0.1 million recorded during the same period in the prior year. [NFP] recorded a gain of $34.1 million during the period related to the investment in [Company], compared to $32.4 million recorded during the same period in the prior year.

Salaries and benefits increased $112.3 million, or 3.3%, over the same period in the prior year primarily due to staffing for higher volumes, wage increases, and an increase in the cost of employee health coverage, partially offset by decreases in pension costs.

Supplies increased $70.0 million, or 7.6%, compared to the same period in the prior year, with supply costs per adjusted admission increasing 5.5%, primarily related to price increases for pharmaceuticals and surgical implants.

Purchased services and other increased $237.7 million, or 13.1%, compared to the same period in the prior year. Excluding the provider fee program costs, purchased services and other increased $120.1 million, or 8.0%, primarily due to increased sub-capitation, medical fees, and management fees, partially offset by decreases in repairs and maintenance costs.

Non-cash market adjustments on swaps, recorded in interest expense, net, were $6.1 million favorable compared to $71.9 million favorable in the same period in the prior year.

Investment income, net was $286.3 million in the six-month period ended December 31, 20X2, compared to income of $240.0 million during the same period in the prior year. Net realized gains of $98.0 million in the current year were higher than net realized gains of $59.9 million during the same period in the prior year. Net unrealized gains were $161.1 million in the current year, compared to net unrealized gains of $156.4 million in the same period in the prior year.

Net income tax credits of $37.3 million were recorded during the six-month period ended December 31, 20X2, compared to a net income tax expense of $4.9 million during the same period in the prior year. The credits relate to the changes in tax law adopted in December 20X2.

Business Strategy

[NFP]'s "Horizon 2020" strategy, which was launched in [Month Year], envisioned the transition to a consumer-focused, value-based operating model, and described six core strategies to achieve [NFP]'s vision: [Vision]. [NFP] has a range of initiatives underway to help the organization succeed in the current environment as well as in the future. Progress on selected key initiatives through December 31, 20X2, is highlighted in the following paragraphs.
Branded Identity and Experience

[NFP]'s [Campaign name] campaign is an integrated effort to articulate the patient and employee experience. The organization has been focused on consumer awareness, brand identity, and delivering the patient experience since the launch of the new name and brand in [year]. [NFP]'s clinical systems, workforce, and marketing strategies are aligned toward delivering an experience of healing through human connection and respect for patients, providers, and employees, consistent with [NFP]'s mission and values and evolving consumer expectations.

Building the Clinical Enterprise

[NFP] is focused on expanding quality, patient experience and integration in its service areas through clinical integration and other physician alignment, and implementation of new payment models. Selected recent accomplishments in these areas include the following:

1. Quality and Patient Experience. [NFP] uses a clinical service line framework to identify and achieve improvements in quality and patient safety. In fiscal 20X3, [NFP] is focused on ten clinical areas, including emergency medicine, critical care medicine, cardiovascular services, hospital medicine, infectious diseases, perinatal services, and pediatrics. The results for the first half of fiscal 20X3 are very positive with marked increases in [specific areas]. [NFP] is also continuing to improve patient experience and increase its [Survey] scores. The [Survey] has ten sections or composites, including nurse communication, responsiveness, physician communication, care transitions, willingness to recommend and communication about medications. [NFP] has a comprehensive plan to improve performance which includes [specific practices]. In the first half of fiscal 20X3, [NFP] has experienced an improvement in all ten composites. The single composite of willingness to recommend (which is the patient experience metric for Horizon 2020 acceleration) increased 10 percentile points from the baseline year of fiscal 20X0.

2. Physician Alignment. [NFP] engages with physicians in a range of models to achieve alignment and integration. Overall, [NFP] continues to expand its physician relationships, including [specific strategies and partnerships].

3. New Payment Models. Economic models that support coordinated care are essential to [NFP]'s success in population health management. [NFP] has focused on participating in new payment models such as [specific models]. As of December 31, 20X2, [NFP] had 136 value-based agreements with more than 1.1 million attributable lives, representing growth of 24% in attributable lives since December 31, 20X1. Value-based agreements are contracts with health care payors and purchasers which include financial risk beyond routine pay-for-performance, negotiated narrow provider networks, and/or direct-to-employer arrangements.
Grow, Diversify, and Expand the Continuum

[NFP]'s growth strategy has focused on building out integrated delivery networks in existing service areas through expansion of the continuum of care and limited in-market consolidation, and growth of diversified services, defined as non-acute business lines with accretive economics. [NFP] has a philosophy of partnering with best-in-class companies to bring expertise to the organization that will facilitate and accelerate the transition to population health management. [NFP]'s joint venture with [Company], a micro-hospital company, is progressing, with four neighborhood hospitals opened in the [City], [State] area. In the [City] area, the joint venture with [Company] has opened ten urgent care centers since August 20X1. Two additional centers are in the planning stage and additional needs assessments are ongoing.

Horizon 2020 Acceleration

[NFP] is engaged at every level of the organization to build on the performance improvement initiatives begun in fiscal 20X1, and has developed a broad, multi-year effort to further improve operating performance. This work is called “Horizon 2020 Acceleration,” as it is critical to realizing the goals set forth in the Horizon 2020 strategic plan. Areas of focus include:

1. Clinical resource management, including continued improvement in length of stay, pharmacy standardization, and further reduction of clinical variation;
2. Further optimization of the hospital revenue cycle function, particularly related to improving clinical documentation and reducing denials and bad debt;
3. Revenue growth, through enhancement of overall revenue mix and growth in specific service lines and geographies;
4. Physician organization performance, including standardizing staffing models and improving the physician revenue cycle function; and
5. Initiatives within supply chain, productivity, and corporate services.

Senior executives and leadership across a wide range of functions within [NFP] are aligned and accountable to achieve these operating improvement goals.

Forward Looking Statements

Certain of the discussions in this document may include "forward-looking statements" which involve known and unknown risks and uncertainties inherent in the operation of health care facilities. Actual actions or results may differ materially from those discussed above, and past or current trends may not continue. Specific factors that might cause such differences include competition from other health care facilities in the service areas of [NFP], federal and state regulation of health care providers, staffing shortages, organized labor initiatives and reimbursement policies of the state and federal governments, and managed care organizations. In particular, statements preceded by, followed by, or that include the word "believes," "estimates," "expects," "anticipates," "plans," "intends," "scheduled," or other similar expressions are or may constitute forward-looking statements.
Management Discussion and Analysis of Financial Condition and Results of Operations [Excerpts]

Introduction

The purpose of this section, Management’s Discussion and Analysis of Financial Condition and Results of Operations (“MD&A”), is to provide a narrative explanation of our financial statements that enables individuals to better understand our financial statements by providing a context by which our financial information may be analyzed.

MD&A should be read in conjunction with the Financial Statements and includes the results of the Foundation through the years ended December 31, 20X2 and 20X1. Certain historical information may also be presented to evaluate trends of current results.

Mission

The Foundation (the “Foundation”) is an organization exempt from federal income taxation under Section 501(c)(3) and is a private foundation as described in Section 509(a) of the tax code. The Foundation seeks to influence the quality of life for future generations through its support of nonprofit organizations working in the fields of health, the environment, arts and culture, education, human services, and community development.

The mission of the Foundation is to [mission].

Strategies and Trends

The Foundation invests in improving the bedrock economic, social, cultural and environmental conditions of urban life, with an emphasis on reducing disparities facing low-income people and advancing their pathways of opportunity, and promoting cultural vibrancy, system of mutual support and environmental sustainability in the communities in which they live.

We employ an array of funding methods to address and advance a set of well-defined programmatic objectives. The funding methods utilized include general operating and project support grants, as well as program-related investments (PRIs). PRIs may take the form of direct loans, guarantees that provide credit support to borrowers, equity investments, or linked deposits.

We focus our efforts in and around the nation’s cities. Home to 80-plus percent of the U.S. population, metropolitan areas give us the greatest potential to open the door of opportunity, particularly for those experiencing poverty and hardship. Cities also tend to foster creativity and be more amenable to new approaches for chipping away at persistent problems.
The Foundation’s broad fields of interest have become seven narrowly defined programs – Arts and Culture, Community Development, Detroit, Education, Environment, Health, and Human Services. Each has a particular point of view with long-term goals and strategies to guide our grantmaking and investing. We partner with those committed to the needs of poor individuals and communities – small, mid-size and large nonprofit organizations, intermediaries, and the public and private sectors.

Governance

Our Board of Trustees is comprised of eleven members, which include eleven independent members and our President and Chief Executive Officer. The Foundation’s business is conducted by its employees, managers and officers, under the direction of its Chief Executive Officer. The original Board was named in 19XX and all future trustees have been elected by a majority vote of the remaining trustees then in office.
Management’s Discussion and Analysis of Financial Results [Excerpts]

We believe it is important to discuss our historical results to provide transparency to our decisions and the resulting impact of those decisions, as well as the impact of external pressures such as economic drivers and our response to those drivers. However, we believe it is just as important, if not more so, to provide forward-looking information to illuminate our path.

Our greatest asset is our dedicated team of staff and volunteers throughout the country that carry out our lifesaving mission on a day to day basis. We will conduct follow up engagement surveys and activities to gauge the success and effectiveness of changes we implemented in 20X0 aimed at increasing engagement with our staff and volunteers across the organization. We will use that valuable feedback to identify opportunity areas to make improvements with the goal of being a more impactful organization for which to work and volunteer.

We continue to analyze our current revenue portfolio and opportunities and in 20X2 will continue investing in our comprehensive, integrated, communication and marketing campaign to increase our relevance to our constituents. A significant component of our strategic growth plan in 20X2 will be focused on increasing revenues in more diverse and operationally efficient ways. We will seek to build strong corporate partners, increase our online presence as well as our major gifts, and explore new revenue models. We will continue to invest and develop our sports and entertainment platform.

Regarding expenditures, our strategic growth plan will continue guiding our mission priorities. We have committed to doubling our investment in life-saving research over the [term], maintain our work in prevention and early detection as well as sharpen our focus on patient access to quality healthcare. Our vision for the future of [disease] control is to help build low-[disease] burden communities by preventing more [diseases], finding more [diseases] early, finding new treatments and cures, and advocating for everyone to benefit equally. Specifically, we will focus on patient transportation, lodging and navigation. Working with the [Strategic Partner], we are planning for the next phase of work to increase [disease] screening beyond 20X2. We have many [Program] facilities under construction and planned for the future and, when complete, we will invest in operating and maintaining those as well as our existing [Program] no-charge facilities to ease the burden of patient and caregiver lodging during [disease] treatment. Continued investment will be made in support of the [Program] as we complete a follow-up survey to study participants in 20X2. We plan to initiate collection of medical records and samples for the same five [disease] sites from the 20XX survey. In addition, numerous other papers are being prepared to assess the reliability of other information collected such as height,
weight, and \textit{disease-related behaviors}. We will also explore the acceptability of establishing a \textit{Program} participant portal for enhancing two-way communication and moving to real-time data collection, particularly among \textit{disease} survivors, through focus groups qualitative studies.

In terms of liquidity, we continue to investigate a number of strategies for reducing the impact of market volatility on our funding requirements and financial results related to our defined benefit plan. In 20X2, we will continue the work of replacing our core and supplemental financial and constituent management systems, which includes a review and reengineering of our internal operations. This investment will continue through 20X3 and will result in efficiencies, which will be a critical aid in driving the success of the enterprise outcomes so that as an organization we are able to support the strategic growth plan objectives both now and well into the future, including a strong focus on our customers. As part of our commitment to expanding research we will begin a program to invest in companies that focus on \textit{disease} research aimed at accelerating outcomes to benefit patients. The investments will be funded by a combination of $25 million of cash reserves and new donations solicited specifically for this important program. Returns generated by these investments will be used for funding additional research and other mission programs.

Over the next few years, all of the above in combination are expected to close the current operating deficit of expenses over revenue. Management and the Board of Directors are monitoring the progress of the deficit situation closely.

Management and the Board of Directors have developed an enterprise risk management framework. In 20X2, we will use that framework to better inform and enhance our operational decisions. Such decisions could affect our financial results as they may guide us to new and different opportunities in the future.

In 20X2, we will be implementing new accounting standards that may impact the format of our financial statements and financial reporting practices as well as our recognition of certain types of revenue. We are also in the process of reviewing the Lease standard to assess the impact, if any, on our financial reporting.

Further discussion of our mission, goals, and progress is provided in our Annual Report, which is available on [website URL]. Any questions should be directed to the Chief Financial Officer at [street address].
Report of the President

[University] looks to the future in a strong position and poised to deepen our service to students, contributions to scholarship and engagement with our community as one of the finest liberal arts colleges in the country.

With discipline and a focus on putting the needs of our students first, [University] ended the fiscal year within our budgeted resources and realized important gains in securing funding for major initiatives to advance our educational program and make available additional high impact, experiential learning opportunities such as internships, research, field placements and study away programs.

In a very competitive and challenging time for higher education throughout the United States, particularly for liberal arts colleges, we were pleased to have Moody’s Investors Service and S&P Global Ratings affirm our long-term ratings of A1 and A+, respectively, with stable outlooks, and we have advanced our plans to build a new Welcome Center. The new center is a significant component of our enrollment strategy and will provide prospective students and their families with the best possible reception and orientation to [University].

While fall of 20X0 saw an entering first-year class that fell below our budgeted projections—a reality that will be with us over the next four years—we exceeded our projected headcount for the incoming class of fall 20X1 and saw growth in several key sectors, including increases in new graduate student enrollment, students transferring from other institutions, and students who identify as underrepresented minorities and first generation college students, in addition to continued growth in the numbers of students who make their homes here in the [region].

In terms of ensuring the university’s long-term financial health and stability, our most significant undertaking of the past year has been the development of a student-centered strategic plan that sets forth our institutional goals and aspirations for the coming decade. Our planning has been informed by strong engagement from trustees, campus community members, alumni, parents, community partners, and other key constituents and friends of the university who have identified ways in which we can make a [University] education even more meaningful, relevant, accessible and distinctive.

Our vision is clear: To challenge and support our students as they become broadly and deeply educated lifelong learners, prepared to create and serve the future and to become the world’s next generation of visionary leaders. More information will be available in the coming year about this innovative plan that seeks to capitalize on what we do well and leverage entrepreneurial opportunities to advance the college.
Like other institutions of higher education, we compete for students in a dynamic and crowded market where shifts in demographics, affordability, government regulation, technology, the political environment, and more require us to be increasingly strategic and adaptive in not only responding to but anticipating change. On the following pages, you will see evidence of our ability to meet these challenges from a position of strength as we seek to reach our next level of distinction and success in service to our academic mission.

**Report of the Executive Vice President and Chief Financial Officer**

[Excerpts]

I offer the following commentary on the university's financial position as a companion to the enclosed financial statements for the year ending June 30, 20X1.

**Consolidated Statements of Financial Position**

**Assets**

Total assets were valued at $668.4 million at June 30, 20X1, providing a sound financial base to support [University’s] mission. Total assets increased 4% in fiscal 20X1 and 35% over the past decade, reflecting healthy growth in endowment and strategic investment in campus facilities that will serve the university well in the future. Liquid resources, endowment investments, and campus facilities comprised 94% of total assets and are discussed below.

- **Liquid resources:** Cash, cash equivalents, and short-term investments totaled $56.5 million and comprised 8% of total assets, at June 30, 20X1, providing ample liquidity to meet operating, capital, and debt service requirements. These liquid resources are invested in accordance with policy established by the finance and facilities committee of the board of trustees and in a manner that preserves capital as a top priority, aligns liquidity with cash flow needs, and seeks to maximize investment return within appropriate risk constraints.

- **Endowment investments:** Accumulated over the university’s long history through the generosity of donors, reinvestment of operating surpluses, and prudent investment management, the endowment grew to $369 million as of June 30, 20X1, a net increase of 7% from the prior year and 51% greater than a decade ago (Figure 2). This important and substantial asset serves [University’s] educational mission by providing annual funding for student financial aid, faculty compensation, faculty and student research and other operating costs. Endowment policies are established by the finance and facilities committee of the board of trustees and executed by its investment subcommittee in collaboration with [University’s] outsourced chief investment officer and co-fiduciary. Individual endowments are pooled for investment purposes to achieve broad diversification and economies of scale. The endowment has become increasingly more diversified as it has grown in value.
• Campus facilities: [University’s] 97-acre campus offers green spaces, stands of fir trees, Tudor Gothic architecture, ivy-covered brick, and 1.5 million square feet of built space designed to support an integrated and inspiring living and learning environment. It is among the top factors students identify as attracting them to [University]. Funded by a combination of generous gifts, strategic use of debt, and unrestricted funds, the university invested $124.5 million in academic, residential and athletics facilities over the last ten years as it continued progress to implement its campus master plan, responsibly maintain its facilities and respond to programmatic changes. The book value of campus facilities, net of depreciation, was $200.4 million as of June 30, 20X1. The university’s average age of plant (accumulated depreciation divided by annual depreciation expense), a measure rating agencies use to gauge deferred maintenance and operating efficiency of campus facilities, is 12.1 years as compared to the 20X0 median of 16.9 years for [University’s] national peer comparison group and 15.7 years for Moody’s small A-rated private colleges.
**Liabilities**

[University’s] liabilities totaled $117.6 million at June 30, 20X1, a reduction of $3.4 million or 3% from the prior year. The university’s largest liability is its long-term debt of $72.3 million. Long-term debt consists primarily of tax-exempt bonds issued to finance strategic projects in alignment with the campus master plan and is discussed below and in Note X to the financial statements.

- At a time when rating agencies assigned a negative outlook to the U.S. higher education sector, Moody’s Investors Service and Standard & Poor’s Global Ratings affirmed the university long-term ratings of A1 and A+, respectively, with stable outlooks, on its publicly traded tax-exempt bonds. These strong ratings help the university access affordable cost of capital and avoid overly restrictive debt covenants.
- The university has been prudent in its use of debt, which is guided by the board of trustees’ debt policy. [University’s] 20X1 debt service as a percentage of operating expenses was 3.9%, as compared to the 20X0 median of 5.4% for its national peer comparison group and 4.8% for Moody’s small A-rated private colleges. [University’s] 20X1 expendable cash and investments-to-total debt ratio was 4:1, as compared to its 20X0 national peer comparison group median of 2.2:1 and Moody’s small A-rated private colleges of 2.4:1.
- Just over half of the tax-exempt debt portfolio was issued as traditional fixed-rate debt, with the balance synthetically fixed using interest rate swap agreements. The university’s swap counterparties, [Bank] and [Bank], are rated Aa2/AA- and A1/A, respectively. Interest rates have risen but are still lower than when the university entered the swap agreements. This results in unrealized mark-to-market valuations shown as a liability in the Statements of Financial Position in the amount of $7.5 million, down from $10.1 million in the prior year and down from $16.1 million as of June 30, 20XX. One of the university’s three swap agreements became “orphaned” when a portion of variable-rate debt was converted to traditional fixed-rate debt as part of a restructuring in 20XX. The orphaned swap had an exit price estimated at $1.8 million as of June 30, 20X1. An ad hoc bond committee of the board of trustees is actively assessing options for managing the orphaned swap, which could result in its full or partial termination.

**Net Assets**

Total net assets increased $32.1 million or 6% to $550.8 million at June 30, 20X1, of which 52% was without donor restrictions and designated for various purposes, 48% was restricted by donors.
Consolidated Statements of Activities

Operating Revenues

Operating revenues and gains totaled $125.7 million, a decrease of 0.4% over the prior year. Figure 6 provides an overview of funding sources that support operations, which is comparable to the prior year.

- Net tuition, fees, room and board: 77% of 20X1 operating revenues were derived from net tuition and fees, room and board, which is comparable to the range of 77% to 79% in the past five years.
  - Tuition and fees, net of financial aid, totaled $75.2 million, a decline of $2.6 million or 3.4% from the prior year. Contributing factors were a rise in discount rate and 93 fewer full-time-equivalent students, reflective of the competitive environment in which [University] operates. Despite this variance, the university ended the year with an operating surplus.
  - Student room and board revenues declined 1% due to lower enrollment discussed above. Collectively, 68% of undergraduate students lived on campus in 20X1, with the remainder typically living within a few blocks of campus, many of whom voluntarily purchased a meal plan.
- Endowment and gift support for operations: Operating support from endowment distributions and donor contributions has a significant and positive impact on financial accessibility for students and the quality and financial health of the university. Revenues from these sources accounted for 16.3% of total operating revenues in 20X1 and served to subsidize the cost of education for all students and provide funding for student financial aid awards (Figure 7).
Endowment distributions of $14.5 million provided 11% of operating revenues in 20X1, up modestly from a decade ago. The endowment distribution was based on a board-approved spending formula that applied a 5% spending rate to a 36-month average endowment market value in a look-back period of July 20XX to June 20XY, which resulted in an effective spending rate (distribution divided by beginning of the year market value) of 4.2% for 20X1. [University’s] 10-year average effective spending rate is 4.5%.

Contributions of $5.9 million were up $1.2 million, or 27%, over the prior year and accounted for 5% of operating revenues.

- Interest Income: Rising interest rates contributed to a 59.1% increase in interest income from cash, cash equivalents and short-term investments, which totaled $1.2 million in 20X1.

**Operating Expenses**

Operating expenses totaled $121.6 million in 20X1, of which $99.4 million, or 82%, are expenses of educational and general activities and $22.2 million, or 18%, are expenses of auxiliary operations. Figure 8 shows [University’s] allocation of educational and general expenses by major functional category in comparison to the most recently available data for its national peer comparison group. [University’s] allocations are within two to three percentage points of the allocations of its national peer comparison group.

Operating expenses increased 2.8% over the prior year, with educational and general expenses up 3.2% and auxiliary expenses up 1.2%. A high-quality liberal arts education is a labor-intensive undertaking and, as such, compensation is the university’s single largest expenditure. Within educational and general expenses, instruction and academic support increased a combined 4.7% due largely to compensation increases, while student services expenses increased just 1.1% and institutional support expenses were essentially flat in comparison to the prior year.

**Increase in Net Assets from Operating Activities**

Operating revenues and gains exceeded expenses by $4.2 million, resulting in an operating margin of 3.3%, as compared to [University’s] five-year average of 4.5%.
Nonoperating Activities

Nonoperating activities totaled $27.9 million in 20X1. Key components included:

- $18.5 million from endowment returns in excess of the $14.5 million distributed for current-year operations. The pooled endowment net investment return was 9.58% in 20X1 vs. a benchmark of 7.88%.
- $5.2 million in donor contributions restricted to facilities and endowment.
- $2.5 million in unrealized gain on interest rate swap agreements.

Closing Remarks

[University] has a long history of fiscal responsibility and balanced operating budgets. It has a track record of developing and implementing strategic plans that continuously strengthen the educational experience offered to its students and the financial foundation required for its success. The university is poised to advance this essential work through implementation of [University’s] 20X1-20Y1 strategic plan, “[Title].”
Additional Resources

Canadian Institute of Chartered Accountants (CICA), MD&A: Guidance on Preparation and Disclosure

Integrated Reporting Framework and example (Indiana CPA Society)

Purpose Beyond Profit