Chapter 14

Accounting for Not-for-Profit Organizations
Learning Objectives

After studying Chapter 14, you should be able to:

❖ Distinguish not-for-profit organizations (NPOs) from entities in the governmental and commercial sectors of the U.S. economy

❖ Identify the authoritative standards-setting body for establishing GAAP for nongovernmental NPOs
Learning Objectives (Cont’d)

≈ Explain financial reporting and accounting for NPOs:

- Required financial statements
- Classification of net assets
- Accounting for revenues, gains, and support
- Accounting for expenses
- Accounting for assets
Learning Objectives (Cont’d)

- Identify unique accounting issues with financially interrelated organizations
- Describe optional fund accounting
- Prepare financial statements using SFAS No. 117
Not-for-Profit Sector

- The not-for-profit sector of the U.S. economy is very diverse, consisting of many different kinds of organizations
  - The majority of NPOs are philanthropic and quite often rely on contributions and the services of volunteers
  - Some NPOs are designed to serve the interest of the organizations’ members
  - Most are not governments or governmental in nature
  - A minority of NPOs are owned or operated by governments
How Does a Nongovernmental NPO Differ from a Business Entity?

- Contributions of resources from providers who do not expect a proportionate return (i.e., nonexchange transactions)
- Operating purposes other than to earn a profit
- Absence of ownership interests (i.e., no one expects a return on their investment)
How Does a *Nongovernmental NPO* Differ from a *Governmental Entity*?

- It was not created by a government, but rather by individuals
- It does not have the power to levy taxes
- It *may* not have the power to levy tax-exempt debt
The FASB, not the GASB, sets accounting and financial reporting standards for nongovernmental not-for-profit organizations. All FASB standards apply to NPOs, but several were released specifically to address NPO issues:

- **FASB Statement SFAS No. 93** — depreciation
- **FASB Statement SFAS No. 116** — contributions
- **FASB Statement SFAS No. 117** — financial statement display
- **FASB Statement SFAS No. 124** — investments
- **FASB Statement SFAS No. 136** — transfers of assets
Other GAAP Guidance for NPOs

- AICPA Audit and Accounting Guide *Not-for-Profit Organizations* (AAG-NPO), with conforming changes each May 1
- AICPA Audit Risk Alerts, also issued each year
- AICPA Checklists and Technical Practice Aids
Financial Statements for NPOs

- Statement of financial position (III. 14-2)
- Statement of activities (III. 14-3)
- Statement of cash flows (III. 14-4)
- Statement of functional expenses for VHWOs (III. 14-5)
- Notes to the financial statements
Statement of Financial Position

- Presents aggregate view of the financial position of the NPO as a whole, rather than a disaggregated view focused on funds
- Can also be called a balance sheet
- Net assets (the difference between assets and liabilities) must be classified into three classes:
  - Unrestricted
  - Temporarily restricted
  - Permanently restricted
- Flexibility in displaying information, including fund-based data, is allowed as long as net assets are classified
Statement of Activities

- Reports on changes in all classes of net assets for a period of time
- Changes take the form of revenues, gains, expenses, and losses
- Net assets released from restrictions decrease temporarily restricted net assets and increase unrestricted net assets, as restrictions are met
- All expenses decrease unrestricted net assets
SFAS No. 117 allows flexibility in presenting information; either a single column or three columns for each class of net assets may be used.

Additional classifications can be used, such as operating and nonoperating, expendable and nonexpendable, earned and unearned, and recurring and nonrecurring.

Expenses are reported by functional categories (i.e., program expenses vs. support expenses).
Statement of Cash Flows

- SFAS No. 95 was amended to apply to not-for-profit organizations as well as for-profit entities
- Cash flows are reported as changes in operating, investing, and financing activities
- The indirect method or direct method (with reconciliation) may be used for reporting cash flows from operating activities
- Unrestricted gifts are reported as part of operating activities
Statement of Cash Flows (Cont’d)

- Restricted contributions given for long-term purposes are included with financing activities along with the related income.
- Noncash gifts or in-kind contributions are disclosed as noncash investing and financing activities in a separate section.
VHWOs must present this statement showing both functional expenses and natural (object or line item) expenses (Ill. 14-5)

**Natural Expenses**

- Salaries
- Supplies
- Depreciation

**Functional Expenses**

- Program
  - Adoption
  - Counseling
  - Education
- Support
  - Mgt and General
  - Fund-raising

**Statement of Functional Expenses**
Traditionally, revenues have been defined as increases in unrestricted net assets that arise from *exchange transactions* in which the other party receives direct tangible benefits commensurate with the resources provided.

Examples include:
- Membership dues
- Program service fees
- Sales of supplies and services
- Investment income
- Some grants
Gains

- Gains are increases in unrestricted net assets that relate to peripheral or incidental transactions of the entity and often are beyond the control of management.

- Examples include:
  - Realized gains on investment transactions
  - Gains on sale or disposal of equipment
Support

Support is a category of revenue (often called contribution revenue) that arises from contributions of resources in nonexchange transactions in which the donor derives no tangible benefit from the recipient agency.
Support Increases:

- *Unrestricted net assets* when no donor restrictions exist or the restrictions have expired
- *Temporarily restricted net assets* when the donor imposes restrictions as to purpose (how the asset is used) or time (when the asset is used)
- *Permanently restricted net assets* when the donor stipulates that the assets must be held in perpetuity, but the organization can spend the income from the assets
Promises to Give

- **Unconditional promises** depend only on the passage of time or demand by the promisee for performance. Record these as support in the period made.

- **Conditional promises** depend on the occurrence of a specified future and uncertain event to bind the promissor, such as obtaining matching gifts by the recipient. Do not record these as support until the conditions are substantially met.
Donated materials (gifts-in-kind) should be recorded as contributions and as expenses (supplies expense or cost of goods sold) at fair value on the date of the gift if an objective, clearly measurable basis for fair value can be established.
Contributed Services

Contributed services should be recorded as contributions and expense (salaries expense) at fair value if the services:

- Create or enhance nonfinancial assets (such as a carpenter constructing a building), or
- Are provided by individuals possessing specialized skills that typically would need to be purchased if not provided by donation (e.g., accountants)
Special events are fund-raising activities in which something of tangible value is offered to donor participants for a payment that includes a contribution.

Examples include:
- Dinner
- Dances
- Golf outings
- Bazaars
- Cookie sales
Special Events (Cont’d)

- If special events give rise to incidental revenue, such as advertising, this revenue is reported in the special events category of support.

- Special event revenue and direct costs of the event should be reported at gross amounts, unless the expenses are peripheral or incidental in nature, in which case they can be netted against the gross revenue.
Expenses

- Recognized on the accrual basis of accounting
- *All* expenses are reported as decreases in unrestricted net assets
- Report depreciation expense for all capital assets, except collections
Joint Costs with a Fund-Raising Appeal

- Report these as fund-raising support expenses, rather than allocating them to functional programs, such as education or advocacy
- Criteria to be applied includes considering
  - Purpose
  - Audience
  - Content
- AICPA SOP 98-2
Mark equity investments that have readily determinable values and all debt securities to fair value

Report realized and unrealized gains and losses and investment income in the statement of activities

Report income and gains and losses as changes in unrestricted net assets, unless their use is restricted by the donor or legally restricted by state law

Similar to FASB requirements for businesses and GASB requirements for governments, but simpler
Investments (Cont’d)

- Donors may stipulate that a portion of appreciation is to be permanently restricted to maintain the purchasing power of the endowment.

- If a donor is silent as to losses, losses reduce unrestricted net assets if the net appreciation requirement has been reached, otherwise they reduce temporarily restricted net assets.

- *SFAS No. 124* requires extensive disclosures regarding investments and related income.
Financially Interrelated Entities

NPOs have varied relationships with other NPOs, for-profit businesses, and governments characterized by:

- **Ownership**—having a financial equity interest in another organization

- **Control**—having the power to appoint the majority of Board members

- **Economic interest**—having the right to receive or use resources or receive income or services, or being obligated to pay the debt of another organization
Funds Received as an Intermediary

*SFAS No. 136*

- Agents report assets and liabilities only and do not follow SFAS Nos. 116 and 117
- An organization is an agent if it receives assets from a donor and agrees to transfer them to a specified unaffiliated beneficiary
  - e.g., United Way or federated fund-raising organizations
Funds Received as an Intermediary
SFAS No. 136 (Cont’d)

- Organizations that are *not* agents report contribution revenue and contribution expense according to SFAS Nos. 116 and 117

- An organization is not an agent if it is:
  - Granted “variance power” to redirect the assets to another beneficiary, or
  - Financially interrelated with the recipient organization (e.g., a captive fund-raising foundation)
Optional Fund Accounting

- NPOs may use fund accounting for internal purposes to facilitate reporting back to grantors or funding agencies.

- *SFAS No. 117* permits NPOs to present disaggregated data classified by fund groups, as long as the aggregated net asset statements are also presented.
Unrestricted current funds (or unrestricted operating or general funds)

Restricted current funds (or restricted operating or specific purpose funds)

Plant funds (or land, building, and equipment funds)

Loan funds (most often in private universities)

Endowment funds

Annuity and life income funds (or split-interest funds)

Agency funds or (custodian funds)
Many NPOs use dual-track accounting:

- Fund accounting for internal purposes and grant reporting
- SFAS Nos. 116-117 for external financial reporting on the entity as a whole