UHY LLP
Certified Public Accountants

NOT-FOR-PROFIT INSIDER

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COMMON ACCOUNTING CHALLENGES FACED BY NOT-FOR-PROFITS

Not-for-profit (NFP) accounting is a unique and often challenging environment that requires specialized knowledge and experience. While having this knowledge is key to successfully managing the accounting and financial reporting of an NFP, we also recognize that many NFPs rely on outside guidance for some of this knowledge.

We work with NFPs of varying sizes and complexities and have put together a list of some specific areas where NFP clients encounter challenges and need our assistance to determine the proper accounting treatment. This list is not all inclusive, and depending on the size of the organization, some of the items may not apply or may not be material. However, as you prepare for year-end, reviewing this list for items that may apply to your organization will help you identify areas that need additional consideration to determine the proper accounting treatment.

Accounting for revenue – Restrictions vs. conditions

Most NFPs are familiar with the concept of donor restrictions and the impact that a time or purpose restriction has on the underlying accounting and revenue recognition. Donor imposed conditions are different than restrictions, and often exist when the agreement requires that one or more barriers must be overcome; and the agreement also has the right of return, or right of release, to the provider/promiser of assets.

Examples of barriers can include the requirement to raise matching funds from other donors; measurable performance measures such as achieving a specified level of service; and the NFP having limited discretion on the conduct of the activity.

If a contribution is deemed to be conditional, then any amounts received are initially recorded as refundable advance liability, and the revenue is subsequently recognized on the date any conditions are considered met. This contrasts with donor restricted contributions which are recorded as revenue when received or pledged.

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The next level of service

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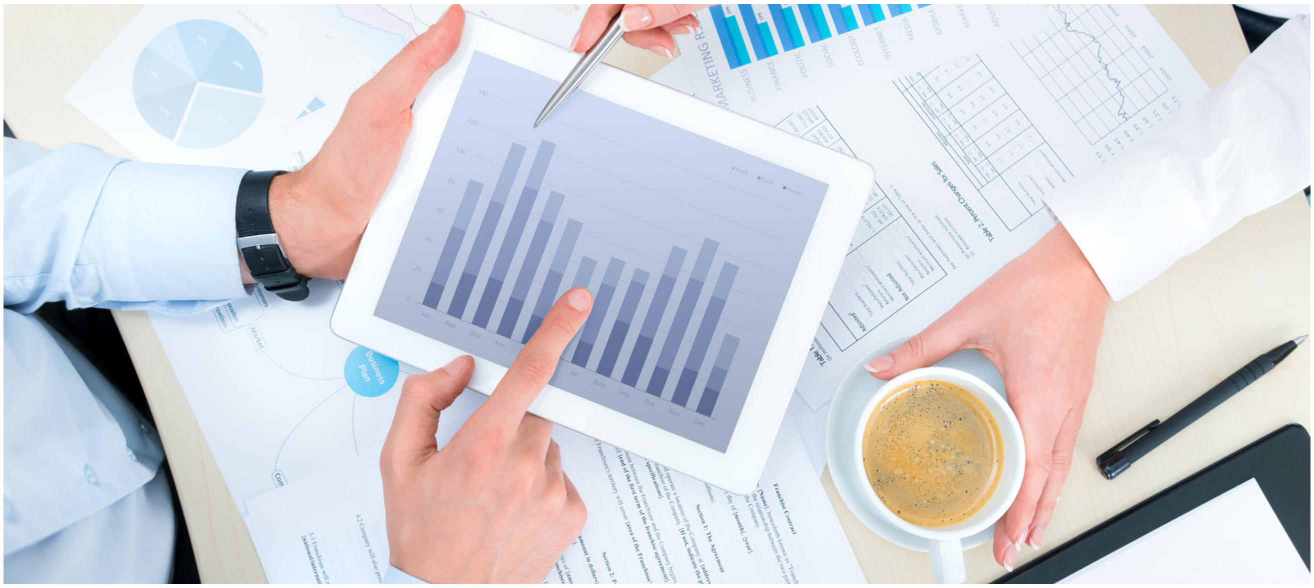

Accounting for in-kind services

Many NFPs rely on some form of donated services for support. This can include day to day volunteers, professional or specialized services, and those for creating or enhancing nonfinancial assets.

Donated services are generally only recorded as in-kind revenue/expense at their fair value if such services require specialized skills that would need to be purchased if not otherwise donated, or creates or enhances a nonfinancial asset such as a building or supplies. Examples can include licensed physicians providing medical services, or volunteers that help renovate the building in which the NFP operates.

If the donated services fail to meet one of these two criteria, then they shouldn't be recorded as an in-kind revenue and expense in the financial statements.

Accounting for auction items

NFPs may hold auctions as a fundraising event whereby items donated by individual and corporate donors are auctioned off. The receipt of items to be used in an auction are considered in-kind contributions.

A two-step process is used to record auction activity. The first step is to record the donated items as an inventory asset and contribution revenue at fair value. After the auction the second step is to remove the inventory asset, record cash, and adjust the contribution revenue up or down based on the difference between the fair value and cash received.

Practically speaking, and depending on the materiality of the auction activity, NFPs might combine the steps and record the activity only one time after the auction is over effectively achieving the same accounting result. However, in the event there are any donated items that are not auctioned off and still held by the NFP, consideration should be given to the need to record an inventory asset.

Discounts and allowances on promises to give

NFPs may receive pledges or grants that are to be received over several years. For example, a donor may pledge an amount to be paid over five years. Two items that are often overlooked with multiyear promises to give are allowances for uncollectable amounts and discounts for the time value of money.

Promises to give should be reviewed regularly for any amounts that are considered to be uncollectable. Promises to give are often based on the donor's best intentions at the time of the pledge, but donor's circumstances can change resulting in amounts that the NFP won't collect. Reviewing the balances for actual or estimated collectability will help ensure that the promises to give are recorded at the amount the NFP expects to receive.

Likewise, promises to give that are collectable in future installments should be discounted for the time value of money. A common method is to use the NFP's investment rate and calculate the present value based on the term of the installments and the investment rate. Similar to recording an allowance, recording a discount will properly reflect the current value of the balances.

Donor restrictions vs. board designations

There is a distinct difference between donor restrictions and Board designations and how they are reported in the financial statements. While they are generally understood, it is still worthwhile to briefly discuss the differences between the two categories.

Donor restrictions are determined by an agreement with the donor and contain some form of time or purpose restriction. How the funds can be used is determined solely by the donor, and the related net assets are considered to be donor restricted until such time that the restriction has been met. Examples include funds that are to be used for a specified purpose or program or a pledge to be received over a specified period of time.

In contrast, Board designations are internal in nature, and are created by a Board or management decision to restrict funds for a specified purpose. The Board or management can also remove the designations at any point. Since the designations are created internally as opposed to a third party donor, they are treated without donor restrictions.

Accounting for releases from restrictions

When donor restrictions have been met, the related net assets should be reclassified from "with donor restrictions" to "without donor restrictions". Properly recording the releases from restrictions is an important function because it gives the readers of the financial statements information about how much of the net assets are set aside for restricted purposes, and how much are available for general operations.

To properly account for the releases, the NFP should be able to track the specific donor restrictions and the related disbursements towards those restrictions. For a given period, the total amount of disbursements that are spent from donor restricted funds would represent the net assets released from restriction. The NFP may adopt a policy whereby donor restricted amounts received and spent in the same year may be recorded as net assets without donor restrictions. However, it is still vital to have a system in place to track the restrictions and spending as noted above.

Also, depending on the sophistication of the accounting software used, the releases may be recorded through a journal entry, or directly to the financial statements. Both are acceptable options assuming the underlying system to account for them is properly designed and functioning.

Accounting for community foundation investments

NFPs may establish an investment fund with community foundations as a means to leverage investment expertise and gain access to planned giving advisory services. The community foundation may also allow donors to make individual contributions on behalf of the NFP directly to the community foundation investment fund.

Amounts transferred to the community foundation that come directly from the NFP are recorded as an asset, usually named "beneficial interest in assets held by community foundation". The related net assets will be considered with or without donor restrictions, depending on the source of the assets transferred, structure of the agreement with the community foundation, or other scenarios. If third party donors make contributions to the NFP's community foundation fund, such amounts are not recorded by the NFP as assets or revenue because they are considered to be made directly to the community foundation.

It is important to identify both of these components so the NFP is able to properly report the balances. The community foundation usually reports the components separately in the information it provides to the NFP.

Trust distributions – One time or periodic/perpetual

NFPs may have a beneficial interest in a trust in which the NFP will receive some form of distribution. These trusts can take several forms, including charitable remainder annuity trusts, charitable remainder unitrusts, and perpetual trusts.

With such trusts, the NFP may be the beneficiary of the trust assets upon an event such as a planned giving decision or the death of the donor. The trust may also be setup where the NFP is the beneficiary of an income stream to be received during the life of the trust. If an NFP is the beneficiary to a trust it is important that the NFP fully understand the nature of the trust agreement to ensure that the accounting and reporting are properly performed. In addition, if an NFP receives an unexpected distribution, it could indicate that they are a named beneficiary of trust which was previously unknown by the NFP. If this occurs, then proper due diligence should be performed to ensure that the NFP understands the details of the agreement.

While these are some of the areas that cause difficulties for NFPs, this is not a comprehensive list. Also, because NFP accounting is so unique, there could be variations of the above situations that may require additional consideration to determine the proper accounting treatment. This list is meant to address some of the situations that we frequently see. Our team of experienced NFP professionals have the expertise to help you understand these situations and other accounting rules and principles that impact your organization.

Mike Federlein, Senior Manager
(Farmington Hills, MI)

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NOT-FOR-PROFIT INDUSTRY INSIGHT

With the increasing complexity of laws and regulations, it's important for associations, foundations, charities, hospitals, schools and other tax-exempt entities to seek out professionals with extensive experience in nonprofit compliance issues. We understand there are many challenges affecting the industry and provide the attention needed to help clients stay focused on their job at hand.

UHY LLP's National Not-For-Profit Practice offers comprehensive audit and assurance, tax planning and compliance and business advisory services to meet the unique, complex needs of nonprofit organizations.

These types of specialized services, which cut across the traditional service lines, demonstrate our philosophy of skilled professionals integrating industry expertise with technical services.

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