The ABC's of Not-for-Profit Financial Reporting

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FINANCIAL STATEMENTS

One of the most important tools you can use to manage the financial condition of your CAP

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Required Financial Statements

FASB ASC 958 – A complete set of financial statements includes:

- Statement of Financial Position
- Statement of Activities
- Statement of Cash Flows
- Voluntary Health and Welfare Organizations should also present a Statement of Functional Expenses

Not-for-profits receiving federal awards are also required to prepare a Schedule of Expenditures of Federal Awards. This schedule is required to be audited, but is not a part of the required financial statements under GAAP.

Schedule of Expenditures of Federal Awards

- (1) List individual Federal Programs by Federal agency.
- (2) For Federal awards received as a sub-recipient, the name of the pass-through entity and identifying number assigned by the pass-through entity shall be included.
- (3) Total Federal awards expended for each individual Federal Program and Cluster and the applicable CFDA number. Identify ARRA funding. Follow 2010 and 2011 compliance supplement, Appendix 5 for guidance on clusters.
- (4) Notes that describe the significant accounting policies used in preparing the schedule. (Usually same basis of accounting as your financial statements)
- (5) Amount provided to sub-recipients from each Federal Program.
- (6) Federal awards expended in the form of non-cash assistance, the amount of insurance in effect during the year, and loans or loan guarantees.

Your financial statements must provide certain basic financial information that focuses on the entity as a whole and meets common needs of external users such as grantors, donors, etc.

Statement of Financial Position

- State total assets and liabilities
- Report net assets for each of the three categories on the face of the financial statement
- Classify assets and liabilities in order of liquidity (assets according to nearness of conversion to cash and liabilities according to nearness of maturity)

Statement of Financial Position

ASSETS

- Cash and Cash Equivalents
- Contributions and/or Pledges Receivable
- Grants Receivable
- Inventories
- Prepaid Expenses
- Investments
- Fixed Assets

LIABILITIES

- Accounts Payable
- Notes Payable
- Deferred or Unearned Revenue
- Accrued Wages and Benefits
- Accrued Vacation
- Long-term Debt

Cash and Cash Equivalents

Cash received with donor-imposed restriction that limits its use to long-term purposes should not be classified with unrestricted cash for current use.

Cash equivalents are defined as short-term, highly liquid investments that are both readily convertible into cash and so close to maturity, interest rate fluctuation would not impact value of the asset. Examples include Treasury bills, commercial paper, money market funds, and certain certificates of deposit (less than 3 month maturity). Not all investments that qualify are required to be classified as cash equivalents. The Agency can establish its own policy.

Contributions Receivable – Promises to Give

Promises to give should be recorded at their expected fair value on the date the promise will be fulfilled and classified in accordance with donor restrictions.

Allowance for uncollectible promises to give should be established to capture subsequent declines in anticipated collectibility of the promises.

Contributions receivable should be classified as permanently restricted, temporarily restricted, or unrestricted.

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Accounts and Grants Receivable

- Report receivables resulting from exchange transactions at net realizable value, if amounts are due within one year, net of allowance for doubtful accounts.
- Allowance is required if it is probable that an asset, the receivable, has been impaired and the loss can be reasonably estimated.

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Inventories

Inventory is valued at lower of cost or market.

Community Actions mostly dealing with finished goods – recorded at cost.

First in-first out method of cost.

Prepaids and Other Assets

Prepaid expenses usually considered current asset – include prepaid interest, rent, insurance, etc.

Other Assets may include deposits, unbilled costs, and fees, etc.

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Investments

Investments in equity securities with readily determinable fair values and debt securities should be measured at fair value. Other investments should be measured at cost, fair value, market value, or the lower of cost and market value depending on the type of organization holding the investments. Investment revenue is unrestricted unless restricted by the donor or by law.

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Types of Investments

Equity Securities

- have sales prices or bid-and-ask quotes available on SEC exchange or over-the-counter market and prices are reported by NASDAQ
- are traded only on a foreign market similar to NASDAQ
- are included in mutual funds

Debt Securities

- include government securities, corporate bonds, convertible debt, commercial paper, and others

Other Investments

- include interests in partnerships and joint ventures, land and other property, and other assets held for investment rather than used in operations.

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Accounting for Investments

- Initial recognition – acquisition cost, net of fees if purchased; fair value on date of donation if received as a contribution; and fair value on date received when receipt is an agency transaction.
- Recognize as increases in unrestricted, temporarily restricted, or permanently restricted net assets based on donor instructions.
- Changes in fair value should be recorded as changes in unrestricted net assets, unless the donor or law restricts use of appreciation of the investments.
- Fair value determined based on selling price of the security on the stock market; market prices of similar security; present value of future cash flows; other valuation techniques.
- Other investments purchased by VHW organization should be reported at cost and if donated, reported at fair value on date of donation. Subsequent to initial recording, carry other investments at lower of cost or market.

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Income from Investments

- Realized and unrealized gains and losses occur when the investment is sold at other than its carrying value and when the fair value of the investment changes.
- Realized and unrealized gains can be netted against realized and unrealized losses on statement of activities.
- Gains and losses reported as changes in unrestricted net assets, unless there are donor restrictions.

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Endowment Funds

Contributions to create donor-restricted endowment funds are assets invested in perpetuity, and the revenue from the investments are used for temporarily or unrestricted purposes. Principal is usually not expendable. Accounting for this type of investments differs from other investments in two areas: classification of net appreciation and classification of losses that reduce the fair value of the endowment below historic cost value.

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Disclosure information for Investments

Details of the investment return:

- Investment income
- Net realized gains or losses on investments reported at other than fair value
- Net gains and losses on investments reported at fair value
- Aggregate carrying amount of investments by type (equity security, U. S. Treasury security, etc.
- Basis for determining carrying value of investments other than equity securities with readily determinable fair values and debt securities
- Significant assumptions in determining fair value of investments other than financial instruments
- Amount of deficiencies for all donor-restricted endowment funds when fair value is less than donor stipulation
- Significant concentrations of market risk
- SFAS 157 disclosures regarding Level One, Two, and Three Fair Value Determinations
- Gross unrealized losses and fair value of investments aggregated by investment category and length of time security has been in a continuous unrealized loss position since financial statement date

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Other Investment

- Split Interest Agreements – Donors set aside assets whose earnings and ultimate disposition are shared between nonprofits and another beneficiary.
- In general, these investments include an executed agreement, contribution element, and asset element, more than one beneficiary, and a period of time element.

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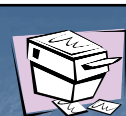
Fixed Assets



- Fixed assets should be carried at cost, if purchased, and at fair value on date received, if contributed.
- If donor restrictions of time or purpose apply, record the contributed asset as an increase in temporarily restricted net assets.
- Routine repairs and maintenance are expensed when incurred.
- Depreciation expense is a systematic allocation of cost of the fixed assets over the estimated life of the asset.
- Recording of fixed assets under GAAP may create reporting differences for grant expenditures. Adherence to grant requirements may cause GAAP departures.

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Payables and Other Liabilities

Current Liabilities are obligations expected to be liquidated through the use of current assets.

- Trade accounts payable
- Bank overdrafts
- Salaries, wages, and other compensation payable
- Payroll and other taxes withheld and accrued
- Accrued pension
- Debt due on demand, such as line of credit.

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Short and Long-Term Debt

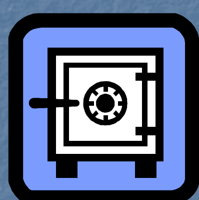
Accounting issues:

Imputed interest – no stated interest, or an unreasonable one, or when face amount of the note is materially different than price of the property, goods, services, etc. Recognize discount on the loan and amortize over the life of the loan.

Obligations over the next 5 years to reduce long-term debt must be disclosed in footnotes.

Deferred Revenue

- Deferred revenue consists only of exchange transaction revenue received in advance of being earned.



Contributions vs. Exchange Transactions

- Contributions are nonreciprocal transfers in that one party to the transaction gives up something of value without directly receiving value in return, i.e. donations of cash or other assets.
- Exchange transaction is reciprocal: each party gives up and receives something of value.

Criteria to determine that an exchange transaction or contribution has occurred

- Resources solicited in exchange for benefits (membership dues which provided services equal in value to dues assessed) = exchange.
- Resources are provided in exchange for benefits (purchase of advertising) = exchange.
- Resource provider specifies delivery method (allowing members to rent space in the facility for special events and providing all the services in the cost) = exchange.
- Resource provider receives value for assets transferred. (Sale of bookstore or craft items) = exchange.

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Contributions vs. Exchange

- Payment based on quantity (specified meals provided to local school on demand and payment made when units are provided) = exchange.
- Transfers include penalties for nonperformance (sponsor of an event places conditions on the sponsor payment, if the agency fails to meet expectations promised to the sponsor, or the event is cancelled) = exchange.

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Typical Sources of Deferred Revenue

- Fees for services
- Governmental grants
- Tuition for classes
- Season ticket sales

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Governmental Grants

- Governmental grants structured as fees for services should be classified as earned revenue and not contributions.
- Grants should be analyzed under the criteria discussed to determine how to be classified.
- Examples of governmental grants as program revenue, contribution revenue, and refundable advances.

- Grant = Earned Program Revenue (unearned revenue to be classified as deferred.) CAP is paid $3.50 per meal provided to a local day care center.
- Grant = Contribution (unearned amount would be temporarily restricted net asset until purpose restriction was met.) Grant received to construct new wing for health care services.
- Grant = Conditional Promise to Give (unearned amount considered refundable advance until conditions of the grant are met.) Grant received to start a new program, and once program is operating for a certain period of time, and the CAP meets certain goals, revenue is earned.

Unrestricted Net Assets

- Unrestricted net assets are those resources that have no DONOR-IMPOSED restrictions on their use. (May be designated). Restrictions may only be placed by a donor.
- All activities under CAP control, such as exchange transactions are unrestricted. All expenses are unrestricted.
- Unrestricted revenues include unrestricted contributions and exchange transactions.
- Temporarily restricted net assets are reclassified to unrestricted when the donor restrictions are met.

Temporarily Restricted Net Assets

- Resources that are limited by donors for use at a certain time or for certain purposes.
- Promises to give with payments in the future carry implied time restrictions.
- Contributions of long-lived assets where the donor stipulates the asset must be used by the CAP (rather than sold).
- Contributions whose restrictions are met within the reporting period may be classified as unrestricted.
- Contributions to a specific appeal or request of the CAP, i.e. Secret Santa, flood relief, etc.

Permanently Restricted

- Resources where donors have placed limitations which do NOT expire over time or by action of the CAP.
- Permanently restricted net assets must be maintained by the CAP in perpetuity.
- No expenses may be recorded as permanently restricted.

Statement of Activities

- Focus on the Agency as a whole.
- Agency may report by fund groups as supplemental data.
- Must report the change in all three types of net assets.

Revenue

- Revenues increase unrestricted, temporarily restricted, or permanently restricted net assets depending upon absence or existence of donor restrictions.
- Gains and losses generally increase or decrease unrestricted net assets, unless use is limited by donor.
- Contributions are voluntary, nonreciprocal, unconditional transfers of cash or other assets to the CAP. This includes exchange transactions where two entities give and receive items of substantially equal values and where a CAP may act as a "pass-through".
- Promises to give are oral or written agreements to contribute cash or other assets to the CAP. May be conditional or unconditional. (Conditional = future and uncertain events must occur before the donor makes the promised transfer. Unconditional = no future events must occur before the donor is bound by his or her promise to make a transfer of benefits to the NPO.)
- Removal, expiration, or satisfaction of donor-imposed condition or restrictions will result in a transfer between temporarily, permanently, or unrestricted net assets.

Contributions

- Classify as either unrestricted, temporarily restricted, or permanently restricted.
- Key concept to remember is to match revenue with the expense in regard to the time period in which they are both recognized.
- True endowments mostly permanently restricted vs. board established endowments which are unrestricted.
- Unrestricted – Donor states funds can be used at CAP's discretion.
- Temporarily restricted – Donor states funds must be used in the CAP's nutrition-related programs, or for the purchase of new vans for transportation of elderly and handicapped.
- Permanently restricted – Donor states funds cannot be spent, but income from the funds may be used for operations.

Sample Journal Entries

- Unrestricted -

Debit Cash
    Credit Contributions

- Temporarily Restricted

Debit Cash
    Credit Temporarily Restricted Net Assets

When spent for the purpose-

Debit Temporarily Restricted Net Assets
    Credit Net assets released from restriction

- Permanently Restricted

Debit Cash
    Credit Permanently restricted net assets

- Investment earnings not restricted

Debit Cash
    Credit Permanently restricted net assets

Debit Permanently restricted net assets
    Credit Net assets released from restriction

Exchange Transaction Revenue

- Revenue should be reported when earned as an increase in unrestricted net assets.
- Exchange transactions are earned by CAP when they charge fees for providing services, when they produce, sell, or deliver goods or services to program participants, clients, etc.
- Resources received from governmental entities in connection with exchange transactions may be limited to certain expenditures, or for the purchase of certain assets. Those resources should be classified as unrestricted revenues and net assets, because those limitations are not donor-imposed restrictions.
- If potential public benefit is secondary to the potential direct benefit received by the grantor = exchange transaction. If grantor receives no value, or if value received is incidental to potential public benefit = contribution.

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Program Expenses

- Expenses should be reported by functional classification either in Statement of Activities or footnotes to the financial statements. Functional classifications include major classes of program services and supporting services. Program services are cost of activities carried out to provide goods and services in accordance with the CAP's mission.

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Program groupings are within the agency's discretion.

Examples include Health and Welfare Programs, Cultural Programs, Educational Programs, Housing Programs, Nutrition Programs, etc.

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- Classify expenses as reduction of net assets.
- Expenses meeting donor restrictions are reclassified from temporarily restricted to unrestricted.
- Describe each major program in your footnotes to financial statements.
- Allocation of expenses related to more than one function.
- Charge the expense directly to function when possible.
- Variety of bases available for allocation of costs, such as, square footage, direct wages, time studies, etc.

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Management and General Expenses

- Management and General supporting services – includes general oversight, business management, general recordkeeping, budgeting, finance and other management, and administrative activities.
- Expenses are indispensable to the conduct of the CAP's mission – are not identifiable with a single program, fund-raising, or membership activity.
- All expenses are classified as reductions in unrestricted net assets.

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Fund-Raising

- Activities include publicizing and conducting fund-raising campaigns, maintaining donor lists, conducting special fund-raising events, preparing and distributing solicitation of contributions from individuals, foundations, or government agencies, etc.

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Statement of Functional Expenses

Voluntary health and welfare organizations are required to continue to report information about their expenses by functional and natural classification in a matrix format in a separate financial statement.

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Purpose of Statement of Functional Expenses – to help donors, creditors, grantors, and others determine how effective the CAP is in fulfilling their mission and using their resources.

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- Statement of Functional Expenses will provide information about expense by functional and natural classification. (Program, Management and General, and Fundraising)
- Expenses relating to more than one function should be allocated among the functions benefitted.
- Fundraising expenses and allocating of joint costs – criteria of purpose, audience, and contents must be met to allocate costs among functions. If any of this criteria is not met, costs are reported as fundraising.

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Cash Flow Statement

- Nonprofits required to include a Statement of Cash Flows as part of a complete set of financial statements.
- Purpose of the statement is to explain the change in cash and cash equivalents from one period to the next. Cash flows from operations can be presented on the direct or indirect method.

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- Contributions restricted by donor for long-term purposes should be excluded from cash and equivalents as these amounts are not available for current use by the CAP. Report this cash separately on Statement of Financial Position as Cash restricted for long-term purposes. Do not include with cash available for current operations and activities.
- For cash flow purposes, this cash is reported as an "inflow" from financing activity. Expenditures of this cash are reported as an "outflow" of investing activities when the actual capital items or endowment funds are "purchased".
- Direct vs. Indirect – Direct = major classes of gross cash receipts and gross cash payments are presented. Indirect = total changes in net assets are adjusted for noncash items.
- Reconciliation of total changes in net assets to net cash flow from operating activities must be provided under both methods.

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Additional disclosures for footnote consideration

- Contributed services – programs affected.
- Reporting of temporarily restricted contributions as unrestricted, if restrictions met in the reporting period.
- Gifts of long-lived assets.
- Promises to give – amounts receivable in less than one year, one year to five years, and more than five years. Also, include any allowance for uncollectible.
- Depreciation on fixed assets.
- Long-term debt maturities in next five years.
- Maturities on capital leases.
- Operating leases.
- Nature and amount of permanent and temporary restrictions.
- Board designations of cash and other assets.

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Key Concepts

- Financial Statement meant to reflect agency as a whole.
- Disclosures supplement information previously reported in the financial statements.
- Financial Statements are management's responsibility.
- Use accounting software to extent possible to produce the required statements.

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Questions?

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THANK YOU FOR YOUR PARTICIPATION TODAY. ANY QUESTIONS MAY BE FORWARDED TO:

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