Accounting for Not-For-Profit Organizations (“NFPOs”)

What makes NFPOs different from profit oriented organizations?
- NFPOs typically provide services or goods without the expectation of profit
- Their resources are provided by individual and government contributors without the expectation of gain or repayment
- They have no readily identifiable ownership interests that can be sold, transferred, or redeemed
- They are governed by volunteers

Fund Accounting Basics:
- Funding received by NFPOs can be categorized as unrestricted or restricted.
  - Unrestricted resources can be used for any purpose consistent with the NFPO’s goals and objectives.
  - Restricted resources can only be used as specified by the external contributor, e.g. a donation may be received with a condition that it be spent in some specified manner.
    - Endowments are restricted donations that must be maintained in perpetuity by the organization, only the interest earned on the endowed funds can be spent.
- Not for profit organizations require a mechanism to identify and track restricted funds. Here's where fund accounting comes in . . .
  - “Fund accounting comprises ... a self-balancing set of accounts for each fund established by legal, contractual, or voluntary actions of an organization. Elements of a fund can include assets, liabilities, net assets, revenues, and expenses ... Fund accounting involves an accounting segregation, although not necessarily a physical segregation, of resources.” [Handbook 4400.02]
- In many not-for-profit organizations, a basic objective of financial reporting is often the tracking of changes in each fund balance over the year and stewardship over fund resources. Think of it from a user perspective - this is what you would really want to see.
- The complete self balancing set of accounts for each fund removes the emphasis from the overall “bottom line” and places it more closely on the individual activity of each fund.
- From an accounting perspective - the total of assets less liabilities of the NFPO will equal the total of the fund balances, the same way that in a business organization, assets less liabilities equals owners' equity.

Key Handbook Sections
- There is a whole section of the HB (4400) dedicated to NFPO's. Some of the key points include:
  - Section 4420, “Contributions Receivable”:
    - A contribution should be recognized as an asset when the amount to be received can be reasonably estimated and the ultimate collection is reasonably assured. Because pledges cannot be legally enforced, recognition should be delayed until cash is received, unless the organization can estimate collectability rates based on historical results.
• Section 4450, “Reporting Controlled and Related Entities by NFPOs”
  o Establishes NFPO presentation and disclosure standards for control, significant influence and joint venture investments in other NFPOs or profit-oriented organizations.

• Section 4430, “Capital Assets Held by NFPOs”
  o New requirement that NFPOs capitalize and amortize all capital assets, but exempts small NFPOs with two-year average annual revenues less than $500,000 from doing so provided they disclose capital assets not capitalized and amortized.

• Section 4440, “Collections Held by NFPOs”
  o Collections (works of art etc. . .) are excluded from the definition of capital assets with the following choices of accounting permitted:
    • Expense when acquired
    • Capitalize but do not amortize
    • Capitalize and amortize

• Sections 4400 and 4410, “Financial Statement Presentation by NFPOs” and “Contributions – Revenue Recognition”
  o Restrictions on an organization’s resources should be clearly stated in the financial statements
  o The matching concept for NFPOs must be applied in the measurement of yearly results. In NFPO matching for restricted revenues when the fund method of accounting is not used, expenses are recognized first and then revenues are matched to expenses.

**NFPO Financial Statements**

• A NFPO must present the following financial statements:
  o A statement of financial position (similar to a balance sheet)
  o A statement of operations
  o A statement of changes in net assets (or fund balances)
  o A statement of cash flows

**Accounting for Contributions**

• To capture the matching concept that is unique to NFPOs, the Handbook has defined two methods of accounting for contributions: the deferral method and the restricted fund method
• If an NFPO does not wish to report on a fund accounting basis, it will use the deferral method
• If an NFPO reports on a fund accounting basis, it will normally choose the restricted fund method
• The deferral method matches revenues with related expenses
  • Unrestricted contributions are reported as revenues in the period received.
  • Endowment contributions are not shown on the operating statements; rather they are reflected in the statement of changes in net assets. This is because endowment contributions will never have related expenses.
• Restricted contributions have to be matched against related expenses. This matching principal has different implications for different kinds of restricted contributions as follows:
  o Restricted contributions for expenses of future periods are deferred and recognized as revenue in the same periods as the related expenses are incurred.
  o Restricted contributions for the acquisition of capital assets subject to amortization: defer and recognize as revenue on the same basis as the asset is being recognized.
  o Restricted contributions for the acquisition of capital assets not subject to amortization (such as land): show on the statement of changes in net assets (same as endowment contributions).
  o Restricted contributions for expenses in the current period: recognized as revenue in the current period (matching is achieved so no need for deferral)
• The restricted fund method requires a NFPO to report a general fund, at least one restricted fund, and, if it has endowments or receives endowment contributions, an endowment fund
  • Endowment contributions: reported as revenue in the statement of operations of the endowment fund.
  • Unrestricted contributions and unrestricted investment income: reported as revenue in the general fund.
  • Restricted investment income: reflected as revenue in the particular restricted fund involved.
  • Externally restricted contributions: record as revenue in the relevant restricted fund. Note: a restricted fund has no deferred revenue because the fund balance represents the amount of restricted resources.
  • Externally restricted contributions or restricted investment income, for which there is no corresponding restricted fund: recorded as deferred revenue in the general fund using the deferral method (see above).
  • Internally imposed restrictions on unrestricted general fund resources: transferred to the relevant restricted fund on the statement of changes in fund balances, below the “excess of revenue over expenses” line.

**Donated Capital Assets, Materials & Services**

• A NFPO is required to record the donation of capital assets at fair value. If fair value cannot be determined, a nominal value will be used.
• A NFPO has the option of reporting or not reporting donated material and services; however, it should only report if fair value can be determined, and if materials and services would normally be used in the organization’s operations and would have been purchased if they have not been donated.
Example:

The open and unadjusted trial balance of the Accountants Benevolent and Beautification Association (“ABBA”) as at December 31, 2008, is presented below.

<table>
<thead>
<tr>
<th>Debits</th>
<th>Credits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>303,000</td>
</tr>
<tr>
<td>Investments</td>
<td>132,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>42,000</td>
</tr>
<tr>
<td>Members equity</td>
<td>215,000</td>
</tr>
<tr>
<td>Contributions received</td>
<td>1,010,000</td>
</tr>
<tr>
<td>Investment income</td>
<td>10,000</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>414,000</td>
</tr>
<tr>
<td>Supplies</td>
<td>139,000</td>
</tr>
<tr>
<td>Rent</td>
<td>30,000</td>
</tr>
<tr>
<td>Equipment purchase</td>
<td>150,000</td>
</tr>
<tr>
<td>Other expenses</td>
<td>109,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,277,000</strong></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,277,000</strong></td>
</tr>
</tbody>
</table>

As the recently elected Treasurer of ABBA, you have the task of preparing the financial statements for presentation at a meeting of the members next week. Your discussions with the other board members and review of the Association’s records have revealed the following additional information.

- Your analysis of the “contributions received” account indicates the following:
  - $146,000 received from the CICA, which is designated to cover the operating expenses of a retraining program for accountants traumatized by their BCIT advanced accounting course. This program has been in operation for several years and the balance of unspent contributions to this program at the beginning of the year was $75,000.
  - $132,000 received from a wealthy individual for the establishment of an endowment fund. This amount was invested in debt securities, which generated the $10,000 of investment income that appears in the trial balance. All of the income earned by these endowment funds is restricted for use in the Association’s retraining program.
  - $150,000 restricted for the purchase of equipment for use in the retraining program. This equipment was purchased at the beginning of the year and has an estimated useful life of five years, with no salvage value at the end of its life. The other board members assume that ABBA can simply expense this purchase but they are looking to you for guidance. ABBA has no other capital assets.
  - The remainder of this account is comprised of unrestricted contributions.
In addition to the contributions received, there is $160,000 of outstanding pledges that are not recorded in the accounting records. The Board believes $127,000 of this amount is collectable based on past results. There are no external restrictions placed on these contributions.

Your analysis of the various expense accounts shows that the operating expenses of the retraining program totalled $106,000 for the year (not including the equipment purchase). $75,000 of this amount was for wages and the balance was for supplies.

Required:


(b) Assume that ABBA has adopted fund accounting and has the following funds: general fund, capital fund, restricted fund, endowment fund. The restricted fund is used to account for the operations of the CICA funded retraining program. Prepare a Statement of Operations and Changes in Fund Balances for the year ended December 31, 2008, and a Statement of Financial Position at December 31, 2008.