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2012

Interpretation and Application of
GENERALLY ACCEPTED ACCOUNTING
PRINCIPLES for Not-for-Profit Organizations

Richard F. Larkin
Marie DiTommaso

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Marie DiTommaso



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PREFACE

Not-for-profit accounting is a specialized field of accounting that is receiving a growing level of attention. Over one million not-for-profit organizations currently operating in the United States have unique accounting and financial reporting issues that must be understood by a growing number of not-for-profit organization financial statement preparers and users.

The Financial Accounting Standards Board (FASB) has issued a series of statements and accounting standards updates that have significantly affected how not-for-profit organizations account for and report their activities and financial position. The overall financial statement format reports “net assets” instead of fund balance or other description of “equity,” and the accounting principles for two key areas for these organizations—contributions and investments—were the topics of separate FASB pronouncements. The American Institute of Certified Public Accountants (AICPA) issued a pronouncement specifying how not-for-profit organizations should account for the joint costs of activities that include fund-raising. The FASB has also issued a statement detailing the accounting for resources which a not-for-profit organization passes through to another organization. The FASB has also finalized the accounting requirements that will apply when two not-for-profit organizations combine, and has also provided guidance for reporting endowments. The FASB has also been active in many areas that affect a broad range of business and other organizations, including not-for-profit organizations. For example, financial instruments, asset impairments, intangible assets, pension obligations, and fair value measurements have all been areas that have been impacted by recent FASB pronouncements. All of these topics are examined in detail in this book.

This year's edition incorporates the codification of accounting standards into the FASB Accounting Standards Codification (the "Codification"). The FASB essentially eliminated the statements on standards and other accounting literature and replaced them with the FASB ASC, which will be frequently updated as the means of promulgating changes in generally accepted accounting principles.

Despite the steady stream of accounting pronouncements that affect not-for-profit organizations, it's important to understand that accounting standards setting has been influenced by a great deal of recent change. The Sarbanes-Oxley Act of 2002 created the Public Company Accounting Oversight Board (PCAOB) which has responsibility for setting auditing and other standards for public companies. Even with all of the new requirements and changes, the FASB continues to set generally accepted accounting principles for both public and nonpublic entities, including not-for-profit organizations. However, the FASB's agenda has continued to focus more on issues affecting public companies, which has likely been influenced by the changes in the regulatory environment and issues highlighted by the numerous accounting shortcomings, and more recently by the turmoil being experienced in the financial markets. The AICPA, through technical practice aids, industry risk alerts, and accounting and auditing guides, continues to be an important contributor to the body of accounting principles used by not-for-profit organizations.

This book is designed as a complete and easy-to-use reference guide for financial statement preparers and users, as well as for auditors of not-for-profit organizations. It focuses on three key areas.

- Distinguishing characteristics of not-for-profit organizations and their financial accounting and reporting

- Accounting areas that are unique to not-for-profit organizations
- General areas of accounting that are applicable to the accounting and financial reporting of not-for-profit organizations

This book would not have been possible without the hard work and efforts of several individuals. John DeRemigis and Judy Howarth of John Wiley & Sons, Inc. provided overall direction in developing the concept for the book and seeing it through to completion. Pam Reh contributed greatly to the production efforts. The authors are greatly appreciative of their efforts.

Richard F. Larkin, CPA

Marie DiTommaso

December 2011

ABOUT THE AUTHORS

Richard F. Larkin is technical director of not-for-profit accounting and auditing for BDO USA, LLP, in Bethesda, Maryland. Previously he was the technical director of the Not-for-Profit Industry Services Group in the national office of PricewaterhouseCoopers. He is a certified public accountant with over forty years of experience serving not-for-profit organizations as independent accountant, board member, treasurer, and consultant. He teaches, speaks, and writes extensively on not-for-profit industry matters and is active in many professional and industry organizations. He has been a member of the Financial Accounting Standards Board Not-for-Profit Advisory Task Force and the AICPA Not-for-Profit Organizations Committee, and chaired the AICPA Not-for-Profit Audit Guide Task Force. He participated in writing both the third and fourth editions of *Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations*, and the AICPA Practice Aid, *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations*. He graduated from Harvard College and has an MBA from Harvard Business School. He is a coauthor of the fourth, fifth, and sixth editions of *Financial and Accounting Guide for Not-for-Profit Organizations*, which were published by John Wiley & Sons, Inc.

Marie DiTommaso has thirty years of experience in accounting and financial reporting in both the not-for-profit and commercial accounting environments. She began her career with KPMG after graduating from Queens College of the City University of New York. Later in her career, she joined the American Express Company and then Dun & Bradstreet Corporation, both to develop, write, and implement accounting policies and procedures. After leaving

these corporate organizations, Ms. DiTommaso served as the chief financial officer of a not-for-profit organization.

Ms. DiTommaso is a member of the American Institute of Certified Public Accountants. She has served as President of the Bergen County chapter of the New Jersey Women Business Owners Association, and as an advisor to its Board of Directors.

NOT-FOR-PROFIT ACCOUNTING LITERATURE

Cross-references between the FASB Accounting Standards Codification (ASC) and Previous Guidance

As more fully described in Chapter 1, the source of all authoritative generally accepted accounting principles for not-for-profit organizations is now contained in the FASB Accounting Standards Codification (ASC). The following tables cross-reference several of the more common ASC sections with the prior FASB pronouncements to assist readers in navigating the ASC.

An additional table in this section lists all of the Accounting Standards Updates (“ASUs” which amend the ASC) issued by the FASB during 2010 and 2011 (through September). Most of the ASUs will not affect the accounting and financial reporting for many, if not all, not-for-profit organizations and are not discussed in this book. However, it is important for the reader to be aware of the changes being made to the ASC so that any potential impacts of these changes can be evaluated. Where a specific ASU is addressed in a chapter of this book, that chapter is indicated in the table.

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30 Split-interest agreements	AAG Ch. 6 DIG B-35
205 Presentation of financial statements	FAS 117, FSP 117-1, FAS 124
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2010-15	Financial Services—Insurance (Topic 944): How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments—a consensus of the FASB Emerging Issues Task Force	
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PART 1

OVERVIEW OF NOT-FOR- PROFIT ORGANIZATIONS

Chapter 1

OVERVIEW OF NOT-FOR-PROFIT ORGANIZATIONS

- **Perspective and Issues**

- Key Differences between Not-for-Profit and Profit Organizations
- Resource Use Consideration
- Generally Accepted Accounting Principles

PERSPECTIVE AND ISSUES

Not-for-profit organizations represent a significant portion of the economy of the United States. Over one million of these organizations provide almost every conceivable type of service from education to politics, from social services to country clubs, and from religious to research organizations. The number and importance of these organizations to the overall US economy continues to grow. The Financial Accounting Standards Board (FASB) defines not-for-profit organizations by distinguishing them from profit organizations. It defines not-for-profit organizations as entities that possess the following characteristics not usually found in other organizations:

1. They receive contributions from significant resource providers who do not expect a commensurate or proportionate monetary return.
2. They operate for purposes other than to make a profit.
3. There is an absence of ownership interests like those of business enterprises.

NOTE: Item 1. above describes transactions that are sometimes called “nonexchange” transactions. In a typical contribution to a not-for-profit organization, the giver (donor) and the receiver (the not-for-profit organization) do not exchange items of equivalent value—the not-for-profit organization receives the majority of the value in the actual transaction. The donor compensates for this difference by obtaining value separate from the transaction, such as through a tax deduction that it is likely to receive, recognition, goodwill, or simply a good feeling about supporting a cause that the donor believes is worthwhile.

While not-for-profit organizations share many of the same accounting principles as commercial enterprises, their accounting and financial reporting is quite unique because the focus of financial reporting for not-for-profit organizations is not on the measurement of net income. Reflecting this, and other differences, the FASB has issued some pronouncements specifically affecting the accounting and financial reporting of not-for-profits. In addition, the application of the FASB’s other accounting standards to not-for-profit organizations typically requires some modification for applying those standards to not-for-profit organizations because the primary focus of financial reporting for not-for-profit organizations is not on the measurement of net income or comprehensive income.

Typically, not-for-profit organizations are controlled by boards of directors composed of individuals who generally volunteer their time. The size of not-for-profit organizations varies greatly. A small not-for-profit organization may have no paid staff; all functions may be performed by a governing board and volunteers. On the other hand, some not-for-profit organizations are quite large with hundreds or even thousands of employees, such as a university, a health-related research association, or a large cultural organization such as a museum. When a small, newly formed organization becomes large enough or complex enough in operation to require it, the board may delegate either

limited or broad operating responsibility to a part-time or full-time paid executive. This executive may be given any one of many alternative titles—president, executive director, administrator, manager, etc. Regardless of the size of the not-for-profit organization, the board will usually appoint one of its own part-time volunteer members as treasurer. In most cases, the treasurer is second in importance only to the chairperson of the board because the ability of the organization to carry out its programs is based upon strong oversight and administration of its finances.

Every board member has a fiduciary responsibility for all of the affairs of the organization, including finances. While the treasurer may be charged with paying special attention to this area, this does not excuse any board member from exercising diligent oversight in the finance, as well as all other areas of operation.

NOTE: In many instances, the board member designated as treasurer is a businessperson who is active in both professional and community affairs and has only a limited amount of time to devote to the organization. Therefore, financial awareness from the rest of the board is necessary as is the appropriate development of a financial function within the organization that has the appropriate skill set given the size of the organization.

The treasurer has significant responsibilities, including the following:

1. Keeping financial records
2. Preparing accurate and meaningful financial statements
3. Budgeting and anticipating financial problems
4. Safeguarding and managing the organization's financial assets
5. Complying with federal and state reporting requirements

While this list certainly is not all-inclusive, most of the financial problems the treasurer will face are associated with

these five major areas.

In the public company commercial accounting environment, the role of the Board of Directors (including Board members who are part of an organization's Audit Committee) has come under close scrutiny recently. This scrutiny has a number of different causes, but certainly the inappropriate (or perceived inappropriate) application of accounting principles by a number of these public companies can be described as one of the more important factors leading to this scrutiny.

While the circumstances receiving public attention relate primarily to public companies, not-for-profit organizations are not immune to the misapplication of accounting principles. Boards of directors, management, and independent auditors of not-for-profit organizations must be vigilant to ensure that accounting principles used are appropriate and are appropriately applied. In addition to meeting the "letter of the law" as found in various accounting standards, not-for-profit organizations must ensure that the applications of generally accepted accounting principles to their financial statements results in statements that truly do present fairly the activities and financial position of the organization.

Not-for-profit organizations that are large enough to be required by the laws and regulations of the state in which they are located to have their financial statements audited each year (or in some cases compiled or reviewed) are increasingly establishing audit committees to oversee this obligation. Generally the audit committee members represent a subgroup of the members of the board of directors, although sometimes nonboard members are invited to join audit committees.

Audit committees generally concern themselves with ensuring the integrity of the financial reporting process of the not-for-profit organization by understanding and