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“I’m Not an Accountant!” Clarifying the Confusion



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“I’m Not an Accountant!” – Clarifying the Confusion

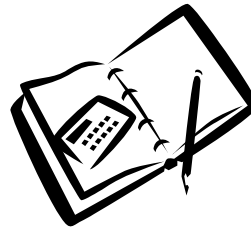
- ***Real World Perspective***
 - ***Art Farris, local nonprofit accountant***



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Clarifying the Confusion

- Topics Covered:
 - Donor restricted funds
 - Property & equipment
 - Noncash contributions
 - Financial Statements



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Donor Restricted Funds

- Unrestricted Funds
- Board-designated Funds
- Temporarily Restricted Funds
- Permanently Restricted Funds





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Donor Restricted Funds

- Unrestricted Funds
 - Funds that are free from donor restrictions and available for general use
 - Most common form of contribution received and essential in covering operational needs



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Donor Restricted Funds

- Board-designated Funds
 - Funds earmarked by the Board for a specific purpose
 - Unrestricted – Board can redirect funds at any time
 - Ex) Endowment fund (Quasi endowment)



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Donor Restricted Funds

- **Temporarily Restricted Funds**
 - Funds that have donor-imposed restrictions
 - Time Restriction - (Ex) For use in future years
 - Purpose Restriction - (Ex) Scholarships, New Building
 - Restrictions can include both time and purpose



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Donor Restricted Funds

- **Permanently Restricted Funds**
 - Funds that have donor-imposed restrictions that never expire
 - Most commonly seen with endowments
 - Principle is to be held in perpetuity
 - Income generated for unrestricted or temporarily restricted purposes



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Donor Restricted Funds

- Why should you care?
 - Legal Obligation
 - Right to reclaim funds if not used properly
 - Civil/criminal lawsuits against board members/management
 - Required by Generally Accepted Accounting Principles (GAAP)



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Donor Restricted Funds

- Real World Examples
 - Princeton University (2008)
 - Misuse of endowment funds for broad programs
 - \$100 million settlement repaid to donor
 - Yale University (1995)
 - Implementation of Western Civilization curriculum
 - \$20 million repayment





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Donor Restricted Funds

- 7 Keys to Proper Management

- #1 - Understanding the donor's intent

- verifiable written documentation

- #2 - Only use restricted fund for intended purpose

- #3 - Never borrow from restricted funds

- #4 - Properly plan and budget for usage of funds



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Donor Restricted Funds

- 7 Keys to Proper Management (*cont'd*)

- #5 - Use monthly financial reporting to avoid inadvertent usage of restricted funds

- #6 - Educate and effectively communicate with all staff and board members

- #7 - Don't be afraid to turn down restricted donations or offer alternative restrictions



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Donor Restricted Funds

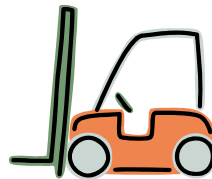
- Best Practices - Recordkeeping
 - Maintain donation records/files for all donors
 - Retain documents that support the donor-imposed restrictions or the lack there of
 - Leverage accounting/office software to properly track restricted funds
 - Incorporate procedural manuals for staff to help define roles and responsibilities



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Property & Equipment

- Capitalization v. Expensing
- Depreciation methods & Useful lives
- Additions & Disposals
- Monitoring Assets





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Property & Equipment

- Why should you care?
 - Users of the financial statements need to know
 - Management/Board Members (decision making)
 - Donors & Lenders (expectations)
 - Property loss insurance records
 - Fire? Vandalism?
 - Required by GAAP



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Property & Equipment

- Definition
 - Assets used in an organization's operations that have an estimated useful life longer than one year
 - Buildings used as operating facilities
 - Office furniture
 - Computers and other administrative equipment



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Property & Equipment

- **Matching Principle**
 - Reasonable and consistent matching of revenue and expenses by allocating the cost of property & equipment over its estimated useful life
 - Capitalization (Statement of Financial Position)
 - Depreciation Expense (Statement of Activities)



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Property & Equipment

- **Capitalization Policies**
 - Capitalization & Depreciation
 - Significant cost typically > \$500; and
 - Useful life greater than 1 year
 - Expense
 - Insignificant cost typically < \$500; or
 - Useful life less than or equal to 1 year





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Property & Equipment

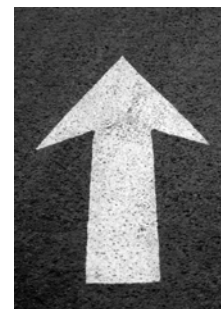
- Common Useful Lives
 - Estimated by management
 - Office equipment - 5 years
 - Furniture & Fixtures - 7-10 years
 - Improvements - 10-20 years
 - Buildings - 40 years



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Property & Equipment

- Depreciation Methods
 - Straight Line Method
 - Cost of the asset is spread evenly over its useful life
 - Most commonly method used by nonprofits





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Property & Equipment

Purchase illustration: \$1,000 Laptop over 5 yr useful life

	<u>12/31/2014</u>	<u>12/31/2015</u>	<u>12/31/2016</u>	<u>12/31/2017</u>	<u>12/31/2018</u>
Equipment (Asset)	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000	\$ 1,000
Accumulated Depreciation	(200)	(400)	(600)	(800)	(1,000)
Net Book Value	\$ 800	\$ 600	\$ 400	\$ 200	\$ 0
Depreciation Expense	\$ 200	\$ 200	\$ 200	\$ 200	\$ 200



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Property & Equipment

- Disposal of assets
 - Sell, junk or trade
 - Removes asset cost and accumulated depreciation from the books and recognizes a gain/loss on the Statement of Activities
 - Gain/Loss = Proceeds less net book value of asset



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Property & Equipment

- Best Practices

- Written capitalization policy
- Periodic monitoring of assets
 - Take inventory of assets
 - Annually review inventory to monitor theft loss or obsolescence
 - Assists in proper valuation of assets on financial statements



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Noncash Contributions

- Donations in the form of goods and service in lieu of cash
- Donated utilities and facilities



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Noncash Contributions

- Why should you care?
 - Helps to track true costs of fundraisers
 - Help to plan from fundraiser needs and expectation from year to year
 - IRS requirements
 - Required by GAAP



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Noncash Contributions

- Recognition (FMV)
 - Recognized at fair market value (FMV) as of the date of the gift
 - If the gift is marketable securities, the value is the average of the highest and lowest selling prices for the day
 - Appraisal may be needed if the FMV is not readily obtainable



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Noncash Contributions

- Who determines the value:
 - Donor is responsible for determining FMV
 - Organizations should not provide fair market values for noncash contributions
 - FMV > \$5,000 = Formal Appraisal Required (donor needs to provide)



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Noncash Contributions

- Example – Real Property
 - Gift
 - ABC nonprofit, received a building and land as a gift from a local corporation for use as an education and training center for ABC's programs.
 - Recognition
 - ABC nonprofit recognizes the property as an asset and as contribution support at its fair value on the date of the gift. The asset is capitalized and depreciated over its useful life. Estimated fair value would be obtained by a property appraisal.



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Noncash Contributions

- Recognition of donated services
 - Does the service create or enhance a nonfinancial asset; or
 - Require specialized skills, are provided by entities or persons possessing those skills, and would be purchase if they were not donated



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Noncash Contributions

- Example – Plumbing services
 - Gift
 - ABC nonprofit sustains a water leak and Bob, the local philanthropist and certified plumber fixes the leak and donates his labor.
 - Recognition
 - ABC nonprofit recognizes the contribution support and the offsetting expense at the fair value of the services provided. Estimated fair value would be determined by the hourly rate and material cost that would have been charged if the work was not donated.



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Noncash Contributions

- Example – Volunteer services
 - Gift
 - ABC nonprofit provides long term care for the elderly. Through a partnership with a local high school, students contribute 10 hours a week performing duties such as talking with patients, distributing books, reading and playing chess with their patients. ABC nonprofit does not typically pay for these services or similar services.
 - Recognition
 - ABC nonprofit would NOT recognize the contributed services. The services do not enhance a nonfinancial asset. The services do not require specialized skills, nor would they typically need to purchase the services if not provided by donation.



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Noncash Contributions

- GAAP versus IRS Requirements
 - Donated services
 - GAAP = Yes
 - IRS = No
 - Donated use of facilities/reduced rent
 - GAAP = Yes
 - IRS = No
 - IRS requirements covered in more detail later



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Financial Statements - Beyond the Numbers

- Common Users
 - Management/Board Members
 - Donors/Grantors
 - Lenders



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Beyond the Numbers

- Types of Financial Statements
 - Self prepared (no external assurance)
 - Compiled Financials (no external assurance)
 - Reviewed Financials (negative assurance)
 - Audited Financials (positive assurance – opinion)



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Beyond the Numbers

- Audit Benefit
 - Transparency can result in increased donor funds
 - Access to larger pool of funds
 - Grants
 - Ex) United Way
 - Foundation funds



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Beyond the Numbers

- Why should you care?
 - Management Perspective
 - How do I make proper financial decisions?
 - Donor Perspective
 - What is my donation going to mean to your organization?
 - If I invest in your organization, will you be good stewards of my money?
 - Lender Perspective
 - Can I rely on your organizations' financial statements?
 - What is your ability to repay debt obligations?
 - Preference for higher level of assurance

HABITAT HOUSE, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 20X7 and 20X6

MYTH
Hoarding Cash is Bad!

**Sustainability &
Financial Strength**

	20X7	20X6
ASSETS		
Cash and cash equivalents	\$ 29,907	\$ 15,655
Short-term investments	62,378	24,833
Accounts receivable	—	1,355
Prepaid expenses	6,402	8,845
Unconditional promises to give	198,188	190,304
Cash restricted to purchase of equipment	30,000	—
Long-term investments	64,875	13,282
Contribution receivable—charitable lead trust	206,800	230,000
Deposits on leased and other property	1,000	1,500
Property and equipment	<u>648,410</u>	<u>664,342</u>
TOTAL ASSETS	<u>\$ 1,247,960</u>	<u>\$ 1,150,116</u>

Source: PPC Financial Statement - Illustrative Example

HABITAT HOUSE, INC.
STATEMENTS OF FINANCIAL POSITION
June 30, 20X7 and 20X6

LIABILITIES		
Accounts payable	\$ —	\$ 3,445
Compensation	4,284	8,145
Refundable advances	2,132	—
Long-term debt	<u>79,991</u>	<u>85,930</u>
TOTAL LIABILITIES	86,407	97,520
NET ASSETS		
Unrestricted		
Designated for new program development	50,000	—
Undesignated	612,559	612,499
Temporarily restricted	492,125	435,932
Permanently restricted	<u>6,069</u>	<u>4,165</u>
TOTAL NET ASSETS	<u>1,161,553</u>	<u>1,052,596</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 1,247,960</u>	<u>\$ 1,150,116</u>

See accompanying notes and accountant's report.

**What restrictions exist on
the assets?**

HABITAT HOUSE, INC.
STATEMENT OF ACTIVITIES
Year Ended June 30, 20X7

Where is our support coming from and is it restricted?

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT				
Contributions				
United Way Services	\$ —	\$ 156,275	\$ —	\$ 156,275
New men's shelter	—	46,193	—	46,193
Capital campaign	—	4,771	—	4,771
Equipment acquisition	—	30,000	—	30,000
Endowment	—	—	2,704	2,704
Other	89,736	—	—	89,736
Federal financial assistance	43,473	—	—	43,473
Program service fees	22,417	—	—	22,417
Investment return	5,766	497	—	6,263
Change in value of split-interest agreement	—	1,800	—	1,800
Other	2,777	—	—	2,777
Net assets released from restrictions				
Expiration of time restriction—United Way Services	146,465	(146,465)	—	—
Restrictions satisfied by charitable lead trust receipts	25,000	(25,000)	—	—
Restrictions satisfied by payments	<u>11,878</u>	<u>(11,878)</u>	<u>—</u>	<u>—</u>
TOTAL REVENUES, GAINS, AND OTHER SUPPORT	347,512	56,193	2,704	406,409

HABITAT HOUSE, INC.
STATEMENT OF ACTIVITIES
Year Ended June 30, 20X7

Detailed by function on Statement of Functional Expenses

EXPENSES				
Program services				
Women and children	134,051	—	—	134,051
Men	94,231	—	—	94,231
Supporting services				
Management and general	55,629	—	—	55,629
Fund-raising	<u>13,541</u>	<u>—</u>	<u>—</u>	<u>13,541</u>
TOTAL EXPENSES	<u>297,452</u>	<u>—</u>	<u>—</u>	<u>297,452</u>
CHANGE IN NET ASSETS	50,060	56,193	2,704	108,957
NET ASSETS AT BEGINNING OF YEAR	<u>612,499</u>	<u>435,932</u>	<u>4,165</u>	<u>1,052,596</u>
NET ASSETS AT END OF YEAR	<u>\$ 662,559</u>	<u>\$ 492,125</u>	<u>\$ 6,869</u>	<u>\$ 1,161,553</u>

See accompanying notes and accountant's report.

MYTH
Profit is Bad!

Profit = Sustainability & Financial Strength

HABITAT HOUSE, INC.
STATEMENT OF FUNCTIONAL EXPENSES
Year Ended June 30, 20X7

	Program Services		Supporting Services		Total
	Women and Children	Men	Management and General	Fund-raising	
Compensation and related expenses					
Compensation					
Full-time	\$ 27,530	\$ 26,049	\$ 31,579	\$ 7,894	\$ 93,052
Part-time	42,531	41,316	7,141	—	90,988
Employee benefits					
Medical	2,020	1,010	861	189	4,080
Other	94	108	254	43	499
Payroll taxes	5,354	5,200	2,926	731	14,211
	77,529	73,683	42,761	8,857	202,830
Conferences and training	215	144	502	—	861
Depreciation	20,644	—	2,534	634	23,812
Food	3,039	76	—	—	3,115
Insurance					
Property and casualty	1,295	515	—	—	1,810
Vehicles	3,785	—	—	—	3,785
Worker's compensation	—	—	1,548	387	1,935
Interest	—	—	248	—	248
Maintenance of equipment	324	—	733	—	1,057

How are we spending donor funds?

Programs ?

Admin ?

Fundraising ?

HABITAT HOUSE, INC.
STATEMENT OF FUNCTIONAL EXPENSES
Year Ended June 30, 20X7

Occupancy					
Electricity	10,964	1,715	975	243	13,897
Gas	1,081	601	105	15	1,802
Heating oil	—	2,054	—	—	2,054
Maintenance	3,449	—	—	24	4,782
Rent	—	—	—	—	8,388
Water and sewer	1,502	—	—	32	2,951
Postage	68	—	—	996	2,100
Printing	434	—	—	1,450	2,990
Specific assistance	1,012	—	—	—	1,286
Supplies					
Cleaning	3,271	—	—	—	5,514
Office	357	365	1,779	432	2,933
Other	971	15	303	27	1,315
Telephone	2,293	874	581	387	4,135
Transportation					
Fuel	409	208	—	—	617
Repairs and other	1,385	680	869	—	2,934
Other	24	—	220	57	301
	<u>\$ 134,051</u>	<u>\$ 94,231</u>	<u>\$ 55,629</u>	<u>\$ 13,541</u>	<u>\$ 297,452</u>

What functional allocation should we strive for?

Program 76%

Admin 19%

Fundraising 5%

See accompanying notes and accountant's report.

CHARITY NAVIGATOR – Online Charity Ratings

Administrative Expenses
Percent of total functional expenses spent on management/general (lower is better)

Converted Score:	10	7.5	5	2.5	0
General:	0% - 15%	15% - 20%	20% - 25%	25% - 30%	> 30%
Food Banks, Food Pantries & Food Distribution	0% - 3%	3% - 5%	5% - 10%	10% - 15%	> 15%
Fundraising Organizations	0% - 7.5%	7.5% - 12.5%	12.5% - 20%	20% - 25%	> 25%
Community Foundations	0% - 10%	10% - 15%	15% - 20%	20% - 25%	> 25%
Museums	0% - 17.5%	17.5% - 25%	25% - 30%	30% - 45%	> 45%

Source: www.charitynavigator.org

CHARITY NAVIGATOR – Online Charity Ratings

Fundraising Expenses
Percent of total functional expenses spent on fundraising (lower is better)

Converted Score:	10	7.5	5	2.5	0
General:	0% - 10%	10% - 15%	15% - 20%	20% - 25%	> 25%
Public Broadcasting and Media	0% - 20%	20% - 25%	25% - 30%	30% - 35%	> 35%

Source: www.charitynavigator.org

HABITAT HOUSE, INC.
STATEMENTS OF CASH FLOWS
Years Ended June 30, 20X7 and 20X6

	20X7	20X6
CASH FLOWS FROM OPERATING ACTIVITIES		
Increase in net assets	\$ 108,957	\$ 461,356
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation	23,812	14,787
Amortization of discount on split-interest agreement	(1,800)	—
Donated vehicle included in contributions	—	(837)
Unrealized gains on investments	(3,256)	(192)
(Increase) decrease in operating assets:		
Accounts receivable	1,355	(677)
Prepaid expenses	2,443	(1,169)
Unrestricted unconditional promises to give	5,748	(2,874)
United Way Services funding for the next fiscal year	(19,682)	(5,563)
Contributions receivable—charitable lead trust	25,000	(230,000)
Increase (decrease) in operating liabilities:		
Accounts payable	(3,445)	300
Compensation	(3,861)	354
Refundable advances	2,132	—
Contributions restricted for long-term purposes:		
Contributions	(79,897)	(195,082)
Amortization of discount on unconditional promises to give	(3,771)	(4,827)
NET CASH PROVIDED BY OPERATING ACTIVITIES	53,735	35,576

HABITAT HOUSE, INC.
STATEMENTS OF CASH FLOWS
Years Ended June 30, 20X7 and 20X6

CASH FLOWS FROM INVESTING ACTIVITIES		
Short-term investments, net	(37,545)	(13,982)
Purchases of long-term investments	(60,837)	(22,749)
Proceeds from maturity of long-term investments	12,500	11,000
Payments for property and equipment	(2,129)	(501,365)
Purchase of assets restricted to investment in property and equipment	(30,000)	—
Other	—	(500)
NET CASH USED BY INVESTING ACTIVITIES	(118,011)	(527,596)
CASH FLOWS FROM FINANCING ACTIVITIES		
Collections of contributions restricted for long-term purposes:		
Capital Campaign	17,771	362,946
New men's shelter	39,243	—
Purchase of equipment	30,000	—
Endowment	2,704	4,165
Payments on Lane Bank note	(876)	—
Payments on SHDA note	(10,314)	(10,314)
NET CASH PROVIDED BY FINANCING ACTIVITIES	78,528	356,797
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	14,252	(135,223)
BEGINNING CASH AND CASH EQUIVALENTS	15,655	150,878
ENDING CASH AND CASH EQUIVALENTS	\$ 29,907	\$ 15,655

See accompanying notes and accountant's report.

HABITAT HOUSE, INC.
NOTES TO FINANCIAL STATEMENTS

NOTE A—NATURE OF ACTIVITIES AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities

Habitat House, Inc. (the Organization) provides temporary housing for the temporarily homeless in Anytown, Georgia. Women and children stay in facilities owned by the Organization, and men stay in rented facilities. Residents are provided with counseling services to help them obtain permanent housing, employment, and financial assistance and to help them with substance abuse problems. The Organization is supported primarily through donor contributions, grants, and the United Way. Approximately 38% and 20% of the Organization's support for the years ended June 30, 20X7 and 20X6, respectively, came from allocations from the United Way.

Promises To Give

Contributions are recognized when the donor makes a promise to give to the Organization that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

The Organization uses the allowance method to determine uncollectible unconditional promises receivable. The allowance is based on prior years' experience and management's analysis of specific promises made.

Source: PPC Financial Statement - Illustrative Example



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BREAK TIME

