*Not-for-Profit Industry Webinar*

# Top 10 Not-for-Profit Accounting Mistakes and How to Avoid Them



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**www.kmco.com**

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# Learning Objectives

- Understand the importance of accounting and reporting processes
- Identify most common mistakes found in not-for-profit accounting
- Discuss how to address and avoid those common mistakes

# Not-for-Profit Accounting & Reporting

- Accountability – Transparency – Compliance
- Unique accounting and reporting practices
    - Contributions – Net Assets – Expenses – Financial Statements
- Impact of recent accounting pronouncements
    - Presentation of Financial Statements for NFPs
    - Revenue Recognition – Contracts & Contributions
    - Collections
    - Intangibles
    - Gifts In Kind
- Enhancing quality – Protecting reputation – Maintaining operational sustainability


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# POLL QUESTION

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# Top 10 Accounting Mistakes

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# Top 10 Accounting Mistakes

I. **Improper revenue recognition**
   1. Exchange vs. Non exchange transactions (contributions)
   2. Conditional vs. unconditional contributions
   3. Contributions with / without donor restrictions
   4. In-Kind contributions (contributed services)

II. **Unrecorded liability**
   5. Deferred rent
   6. Accrued Compensated Absences

III. **Technology**
   7. Website development costs
   8. Cyber Security

IV. **Others**
   9. Internal Control
   10. Functional Allocation of Expenses

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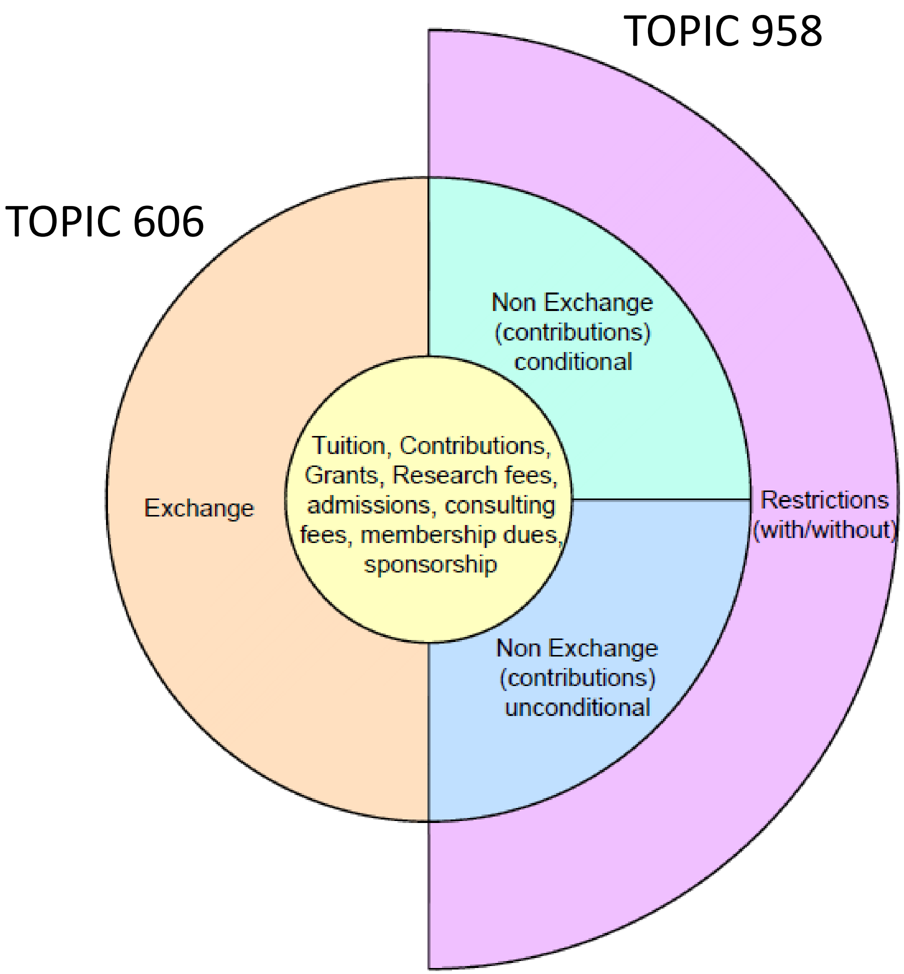
# Accounting Mistake #1- #3




**Revenues & Revenue Recognitions**

**#1 - Exchange vs. Non exchange**

**#2 - Conditional vs. Unconditional contributions**

**#3 - Contribution with vs. without restrictions**

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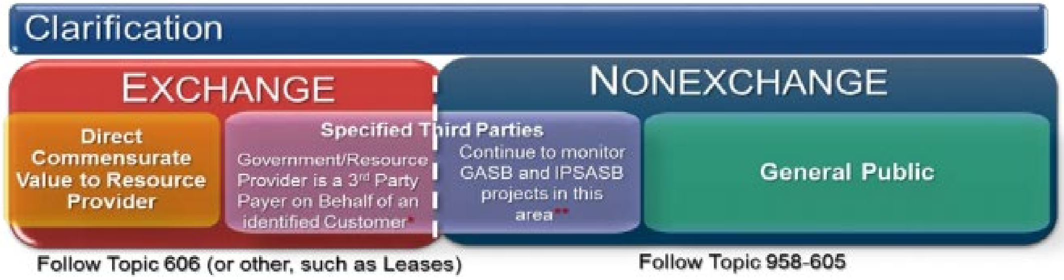
# Accounting Mistake #1

**Revenue recognition : Exchange vs. Non exchange transactions**

Who receives the benefit?




**EXCHANGE**

- Each party (resource provider & receiver) directly receives commensurate value.
- Resource provider is a 3rd party payer on behalf of an **IDENTIFIED** customer.

**NON EXCHANGE**

- No commensurate value exchanges between resource provider & resource receiver
- Resource provider pays for general public.
- Resource provider is a 3rd party payer on behalf of a **NON-IDENTIFIED** customer

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# Accounting Mistake #1

**Revenue recognition: Exchange vs. Non exchange transactions**

- Resource provider is a 3rd party payer on behalf of
  - **IDENTIFIED** customers – **Exchange** transactions
    - Healthcare Entity A (resource receiver) provides medical services to **Patient X** (identified customer) and receives a payment from a governmental entity (resource provider) on behalf of the patient.
  - **NON IDENTIFIED** customers – **Non exchange** transactions
    - Social Service Agency A (resource receiver) provides drug rehabilitation services to **eligible individuals** (non identified customers). Individuals sign up and go through Agency A's intake process to receive the service but payment for the service is made under a government contract. Agency A determines who qualifies for the program.

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# Accounting Mistake #1

## Revenue recognition: Exchange vs. Non exchange transactions

| | **Exchange** | **Non exchange (Contributions)** |
|---|---|---|
| Resource provider pays for | Resource Provider | General Public |
| /on behalf of | Identified customers | Non identified customers |
| Examples | Tuition, admission, consulting fees, grants | Contributions, grants |
| Follows | Topic 606 | Topic 958 |
| Revenue recognized | When the performance obligation is satisfied | When pledged (Unconditional) |
| | (AT point in time or over a period of time) | When conditions met (Conditional) |

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# Accounting Mistake #1

**Revenue recognition : Exchange vs. Non exchange transactions**

- Example 1: NFP A has annual dues of $100 and the only benefit members receive is a monthly newsletter with a fair value of $24.
  - **1) Exchange transactions**
    - $24 of the dues are received in an exchange transaction
    - Follows ASC 606
    - Revenue is recognized **when the performance obligation is satisfied** (evenly over the period of the membership)
    - Recorded as **liability** when received.
  - **2) Non Exchange transactions**
    - $76 of the dues are a non exchange transactions.
    - Follows ASC 958
    - Recognize **revenues** when received. (Unconditional)

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# Accounting Mistake #1

**Revenue recognition: Exchange vs. Non exchange transactions**

**How to address:**

- Document revenue sources and process for evaluating and determining type and the related accounting rules
- Develop standard revenue recognition policies with guidelines

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# Accounting Mistake #2

**Conditional vs. Unconditional contributions (Non exchange transactions)**

- Important to distinguish - Different revenue recognition rules apply

| | CONTRIBUTIONS (NON EXCHANGE TRANSACTIONS) | |
|---|---|---|
| | **Unconditional contributions** | **Conditional contributions** |
| Condition | No | Right of return **&** Barrier |
| Examples | Typical donation made by an individual | Matching Grant, Reimbursable Grant |
| Revenue recognized | When received/pledged | When conditions met |
| When received | Revenues | Liability |

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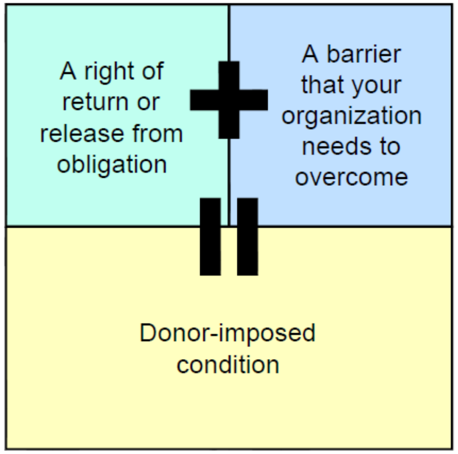
# Accounting Mistake #2

**Conditional vs. Unconditional contributions**

- Condition: **Donor-imposed requirement** that specifies a future and uncertain event that **has to** occur in order for the not-for-profit to **retain** or **receive** the transferred assets.
- For a donor-imposed condition to exist




- **The right of return/ release from obligation** MUST be contained in the agreement **AND**
- The agreement must include **a barrier.**

# Accounting Mistake #2

**Conditional vs. Unconditional contributions**

<u>**Barrier**</u>

- **Measurable performance**
  - Achieving specified level of service/outcome
  - Matching

- **Limited spending direction**
  - Qualifying expenses or specific protocols stipulated by the funder

- **Primary purpose agreements**
  - A stipulation must be related to the <u>**purpose of the agreement**</u> in order to qualify as a barrier
  - FASB guidance intends for organizations to <u>**exclude**</u> items that are administrative & trivial (Audit report)

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# Accounting Mistake #2

**Conditional vs. Unconditional contributions**

- Example 1:
  - UNITED VETERANS organization provides various services and programs to the veteran community. The organization receives an **up-front grant of $500,000** from a foundation for its job training program. The grant requires UNITED VETERANS to provide **training to at least 1,000 qualified veterans**. It contains **a right of return of funds** received for the ratable portion of veterans not receiving training.

- Example 2:
  - Company A promised unconditionally to give the UNITED VETERANS $100,000 per year for five years.

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# Accounting Mistake #2

## Conditional vs. Unconditional contributions

**<u>How to address</u>:**

- Determining whether contribution or grant agreements are conditional can be a challenge. Many grants contain stipulations on spending funds that are unclear - reach out to donors to provide clarity.


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# Accounting Mistake #3

**With Donor Restrictions vs. Without Donor Restrictions**

- Not related with the revenue recognition/ but related with the **presentation**.

**Statement of Activities and Changes in Net Assets**
**Year Ended June 30, 2020**

| | 2020 | | |
|---|---|---|---|
| | Without Donor Restrictions | With Donor Restrictions | Total |
| Revenue | | | |
| Research fees | $ 4,857,151 | $ - | $ 4,857,151 |
| Education and training | 506,345 | - | 506,345 |
| Contributions | 931,116 | 368,651 | 1,299,767 |
| Net assets released from restrictions | 284,252 | (284,252) | - |
| Total revenue | 6,578,864 | 84,399 | 6,663,263 |

- Without donor restrictions
- With donor restrictions
  - Time restrictions
  - Purpose restrictions

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# Accounting Mistake #3

**With Donor Restrictions vs. Without Donor Restrictions**

- With donor restrictions
  - **Time restriction**– A donor imposed restriction that requires the resources to be used in **a later period or after a specified date**
    - A not-for-profit receives a $100K pledge from a donor, who will pay it in two years. The revenue associated with the receivable would be displayed as revenue with donor restrictions (time restrictions).
  - **Purpose restriction –** A donor imposed restriction that requires resources be used for a **specified purposes**
    - A not-for-profit organization receives $100K restricted by a donor for use on a specific project - youth education.

| | Without Donor Restrictions | With Donor Restrictions | Total |
|---|---|---|---|
| Revenue | | | |
| Contributions | - | 100,000 | 100,000 |

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# Accounting Mistake #3

**With Donor Restrictions vs. Without Donor Restrictions**

**How to address:**

- Funds with donor restrictions must be kept separate.
- If the organization has any contributions with restrictions, track expenditures very carefully and record revenue releases only after the restrictions have been satisfied.
- Internal controls should include clear monitoring of asset restrictions as well as the movement of funds as restrictions change or expire.


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# Accounting Mistake #4

**In Kind Contributions (contributed services)**

- US GAAP requires the following two contributed services to be recorded as contributions **at fair market value.**
  1) Donated services that create or enhance a nonfinancial asset
  2) Donated services that require special skills, as long as they meet two additional requirements:
     - The services are performed by someone who possesses those skills and
     - The services would need to be purchased if they were not donated.

- Contributed services that **do not meet** these criteria are **not recognized** by the organization.

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# Accounting Mistake #4

**In Kind Contributions (contributed services)**

- **<u>How to address</u>**
  - Procedure needs to be put in place to ensure that all qualified donated services are properly recorded in the books.
  - Detailed records and documentations should be maintained to support the amount recorded in the financial statements.
  - Written policy should be formalized to specify a method used to determine the fair market value of donated services.

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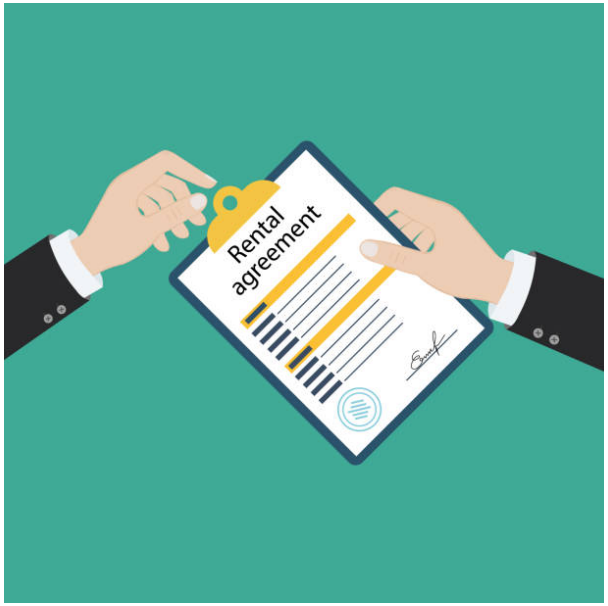
# Accounting Mistake #5




**Unrecorded Liability – Deferred Rent**

- Liability resulting from the difference between **the actual amount paid** and the **straight line expense** recognized in the financial statements
- Under ASC 840, total rent expense is required to be recognized on a **straight-line basis** over **the lease term even if rent payments vary**.
- When a lessee is given free rent in one or more periods

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# Accounting Mistake #5

## Unrecorded Liability – Deferred Rent

| | | Months | Monthly Expense | | | | | |
|---|---|---|---|---|---|---|---|---|
| March 2018- Feb 2019 | 26,597.97 | 9.00 | 2,955.33 | | Payment | SL Expense | Difference | Cumulative Diff |
| March 2019- Feb 2020 | 36,146.00 | 12 | 3,012.17 | Mar-18 | - | 3,020.29 | (3,020.29) | (3,020.29) |
| March 2020- Feb 2021 | 36,828.00 | 12 | 3,069.00 | Apr-18 | - | 3,020.29 | (3,020.29) | (6,040.57) |
| March 2021- Feb 2022 | 37,510.00 | 12 | 3,125.83 | May-18 | - | 3,020.29 | (3,020.29) | (9,060.86) |
| March 2022- Feb 2023 | 38,192.00 | 12 | 3,182.67 | Jun-18 | 2,955.33 | 3,020.29 | (64.96) | (9,125.81) |
| March 2023- Feb 2024 | 38,874.00 | 12 | 3,239.50 | Jul-18 | 2,955.33 | 3,020.29 | (64.96) | (9,190.77) |
| March 2024- Feb 2025 | 39,556.00 | 12 | 3,296.33 | Aug-18 | 2,955.33 | 3,020.29 | (64.96) | (9,255.72) |
| | 253,703.97 | 84.00 | | Sep-18 | 2,955.33 | 3,020.29 | (64.96) | (9,320.68) |
| | 3,020.29 | | | Oct-18 | 2,955.33 | 3,020.29 | (64.96) | (9,385.63) |
| | | | | Nov-18 | 2,955.33 | 3,020.29 | (64.96) | (9,450.59) |
| | | | | Dec-18 | 2,955.33 | 3,020.29 | (64.96) | (9,515.54) |
| | | | | Jan-19 | 2,955.33 | 3,020.29 | (64.96) | (9,580.50) |
| | | | | Feb-19 | 2,955.33 | 3,020.29 | (64.96) | (9,645.45) |
| | | | | Mar-19 | 3,012.17 | 3,020.29 | (8.12) | (9,653.57) |
| | | | | Apr-19 | 3,012.17 | 3,020.29 | (8.12) | (9,661.69) |
| | | | | May-19 | 3,012.17 | 3,020.29 | (8.12) | (9,669.81) |
| | | | | Jun-19 | 3,012.17 | 3,020.29 | (8.12) | (9,677.93) |
| | | | | Jul-19 | 3,012.17 | 3,020.29 | (8.12) | (9,686.05) |
| | | | | Aug-19 | 3,012.17 | 3,020.29 | (8.12) | (9,694.17) |
| | | | | Sep-19 | 3,012.17 | 3,020.29 | (8.12) | (9,702.29) |
| | | | | Oct-19 | 3,012.17 | 3,020.29 | (8.12) | (9,710.40) |
| | | | | Nov-19 | 3,012.17 | 3,020.29 | (8.12) | (9,718.52) |

**How to address:**

- Establish controls to ensure rent expense and the appropriate deferred rent liability are recorded properly.

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# Accounting Mistake #6

**Unrecorded Liability - Compensated Absences**

- Employer's policies may provide for accumulated rights that carry forward to future periods if they are not used in the current period.
- US GAAP requires accruing a liability for the cost of these future absences when all the following conditions exist
  - The employer's obligation to pay for future absences arises from employees' services already rendered
  - The obligation relates to rights that vest or accumulate
  - Payment of compensation is probable; and
  - The amount to be paid can be reasonably estimated
- A company with a "use it or lose it" policy for vacation or sick pay would not need to accrue a liability because their employees' sick and vacation days do not vest or accumulate.

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# Accounting Mistake #6

## Unrecorded Liability - Compensated Absences

**How to address:**

- Policies and procedures should be clearly explained in the organization's employee manuals.
- Management should review the balance at year-end to ensure compliance with the policy limitations.


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# Accounting Mistake #7

**Website Development Costs**

- FASB ASU 350-50 – Guidance for recording costs related to website development.
- Some of the costs can be expensed and other costs may be capitalized depending on the stage of the website development project.
  - Existing website
    - Improvement to an existing website that **updates content** or **improves ease of use**, but not functionality – costs are **expensed** when incurred.
    - Upgrade and enhancement that increase **functionality** – costs are **capitalized**.

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# Accounting Mistake #7

**Website Development Costs**

- An entirely new website or the addition of significant new functionality
  - Planning the website - **Expense**
  - Developing Application and infrastructure - **Capitalize**
  - Graphic Development - **Capitalize**
  - Content Development Stage
    - Input content into a website - **Expense**
    - Software used to integrate a database with a website - **Capitalize**
  - Operating stages
    - Upgrades and enhancements that increase functionality - **Capitalize**
    - Costs to register the website with internet search engines - **Expense**

**How to address**

- Develop a system to track the amount and nature of the work completed on the project.

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# Accounting Mistake #8

**Cyber Security**

- Major risk to organizations
  - Hackers attack every 39 seconds and 2244 times a day on average (From University of Maryland research)
  - Working remotely trend after COVID 19 is making organization more vulnerable to rising threats

- Many not-for-profits do not have or know of a policy that identifies how their organization handles cybersecurity risk and data privacy
  - Only 20% of not-for-profits have a policy in place to address cyber attacks
  - Only 26% of not-for-profits actively monitor their network environments
  - 59% of not-for-profits do NOT provide any cyber security training to staff on a regular basis

(From NTEN, The Nonprofit Technology Enterprise Network)

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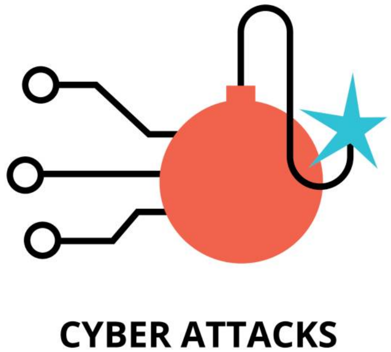
# Accounting Mistake #8

**Cyber Security**

Cyber attack outcomes

- Data breach
- Ransom payment
- Forced downtime
- Wrong payments to fake invoices/ bills




**How to address:**

Management should evaluate the organization's cyber security governance as part of their ongoing risk management procedures.

- Prevention is the No.1 goal in cyber security
- Have a cyber security protocol in place to help prevent cyber attacks
- Develop a rapid cyber attack incident response plan
- Have proper cyber insurance coverage
- Promote organization-wide awareness: provide trainings!
- Kreischer Miller offers a complimentary cyber health check to assist with establishing a proper cyber protocol

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# Accounting Mistake #8

1. 9 Cybersecurity tips for small not-for-profit organizations
   https://future.aicpa.org/resources/article/9-cybersecurity-tips-for-small-not-for-profit-organizations
2. Cybersecurity for Nonprofits
   https://www.councilofnonprofits.org/tools-resources/cybersecurity-nonprofits
3. Cybersecurity: What all Nonprofits need to know
   https://themodernnonprofit.com/nonprofit-cybersecurity
4. Cybersecurity for Nonprofits – NTEN
   https://www.nten.org/wp-content/uploads/2020/02/Cybersecurity-for-Nonprofits_-February-2020.pdf

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# Accounting Mistake #9

**Internal Controls**

- The Oversight:
  - Lack of written documentation
  - Outdated documentation
  - Lack of understanding
  - Limited staff
- **<u>How to address</u>:**
  - Invest time and effort to evaluate and document
  - Identify areas that have potential risk
  - Primary accounting processes – procedures manual
  - Key policies – governance, financial oversight
  - Educate and train staff


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# Accounting Mistake #10

**Functional Allocation of Expenses**

- The Oversight:
  - Understanding of requirements
  - Using budgeted expenses and/or budgeted allocations
  - Failure to include all expenses (except investment mgmt. fees)
  - Natural vs. Functional


- **<u>How to address</u>**:
  - Understand “program service”, “management and general”, “fundraising”, and “membership development”
  - Document allocation methodology

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# Questions?

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# Thank you for your participation!

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# Contact the Presenters:

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