



## Accounting Issues in the Nonprofit Sector

### **KSCPA**

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# Introductions



**René Larsen**

**Director**

René leads the Forvis Mazars' Kansas City Nonprofit Advisory Services team. She has more than 30 years of experience with both nonprofit and for-profit organizations. Her expertise includes audit preparation, financial reporting, identifying best practices, and operational assessments. René works with her clients to provide an understanding of the financial health of their organizations along with recommendations on how to continuously improve.



**Karen O'Mara**

**Senior Manager**

Karen is a senior manager in Forvis Mazars' accounting and auditing practice. Her expertise in US GAAP and internal controls has been pivotal in guiding diverse clients through intricate audits. The role of assurance senior manager has allowed her to leverage a strong foundation in financial regulations to ensure excellence in compliance and reporting. Karen provides strategic insights that help clients navigate the financial implications of their business decisions. This consultative approach, coupled with a deep understanding of various industry sectors, empowers companies to achieve their financial objectives.



# Agenda

1. Introductions
2. Contributions
3. Lease reminder
4. Functional Expenses
5. Endowments
6. Questions



# 01

## Contributions



# Promise to Give

- Promises to give – NFPs may enter into written or oral agreements with donors and the promise will be recorded even if the promise is not legally enforceable
- Unconditional promise to give – before a promise to give is recognized, certain documentation should exist. Such documentation may be included in written or verifiable oral communications, including:
  - Written agreements
  - Pledge cards, and
  - Oral promises
- Conditional promises to give

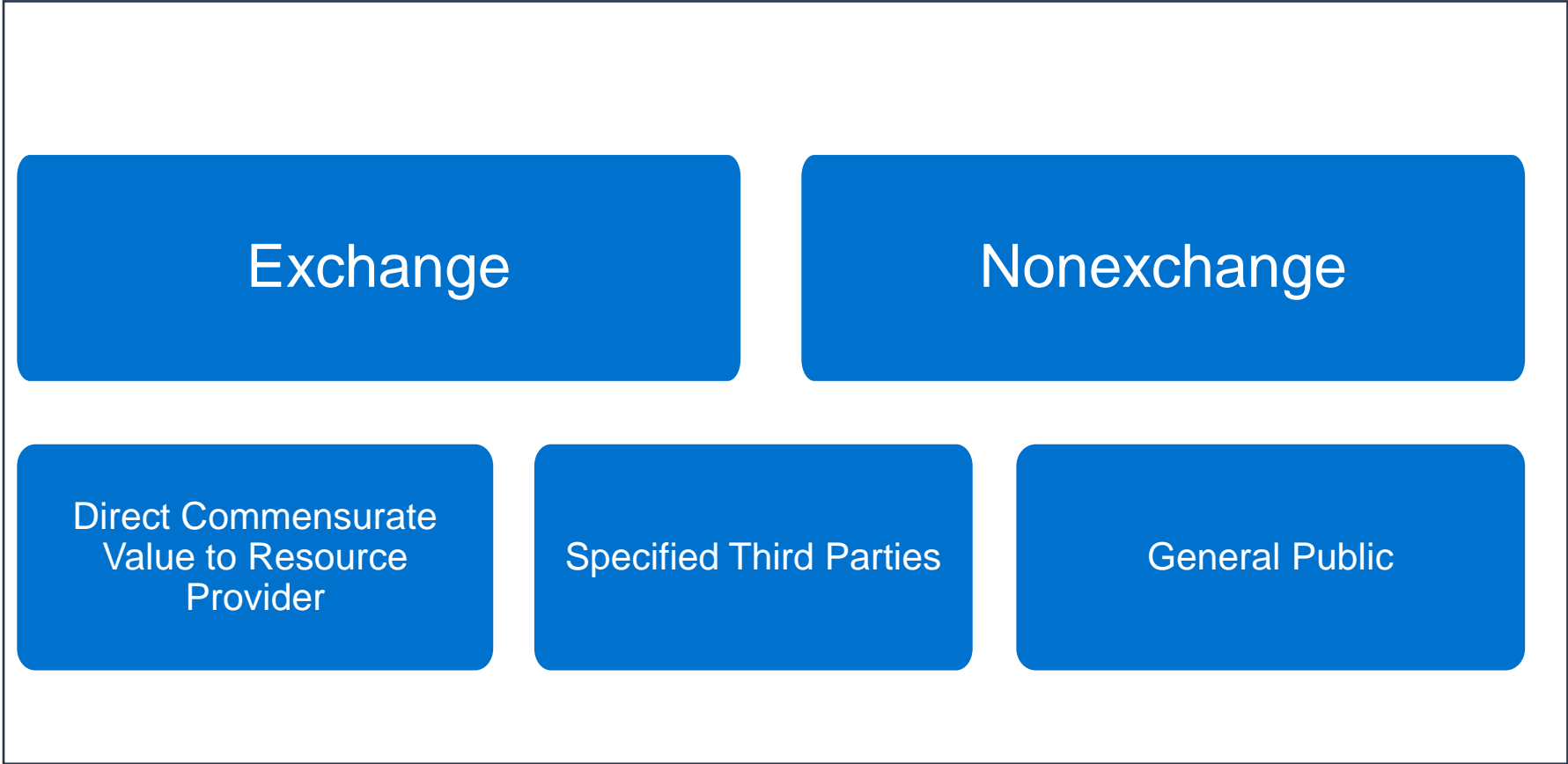
# Intentions to Give

- Legally enforceable matters
- Example, wills – not recorded until it has left probate
- Solicitations for donations that clearly include wording such as “information to be used for budget purposes only” or that clearly and explicitly allow resource providers to rescind their indications that they will give are intentions to give rather than promises to give and should not be reported as contributions.

# Revenue Recognition

- Step 1: Exchange vs. Nonexchange
  - Exchange transaction when resource provider is receiving commensurate value in return for the resources transferred
- Step 2: Conditional vs. Unconditional
  - Conditional contributions when there is a barrier to overcome & right of return/release

# Step 1: Exchange vs. Nonexchange





## Step 1: Exchange vs. Nonexchange

- Direct commensurate value received by the resource provider in exchange for the resources provided
- The resource provider, *e.g.*, government, is not synonymous with the general public
- Furthering a resource provider's mission, a “feel good” sentiment, or receiving name recognition does not constitute commensurate value
- Type of resource provider or name of award should not override the substance of the transaction
- If the beneficiary of a grant or contract is a third party, judgment is required

# Transactions on Behalf of Specified Third Parties

- Judgment required to determine whether a transaction is a third-party payment on behalf of an identified customer, or a contribution restricted for groups of beneficiaries with eligibility criteria
- Examples
  - A social service NFP provides drug rehabilitation service to individuals who sign up for the service but payment for the service is made under local government contract
  - An affordable housing NFP receives two forms of government payments to support the housing of individuals at a specific building
    - Rent voucher payments associated with individual residents
    - An operating subsidy for housing individuals that meet income criteria

# Step 2: Conditional vs. Unconditional Contributions



# Indicators to Determine a Barrier

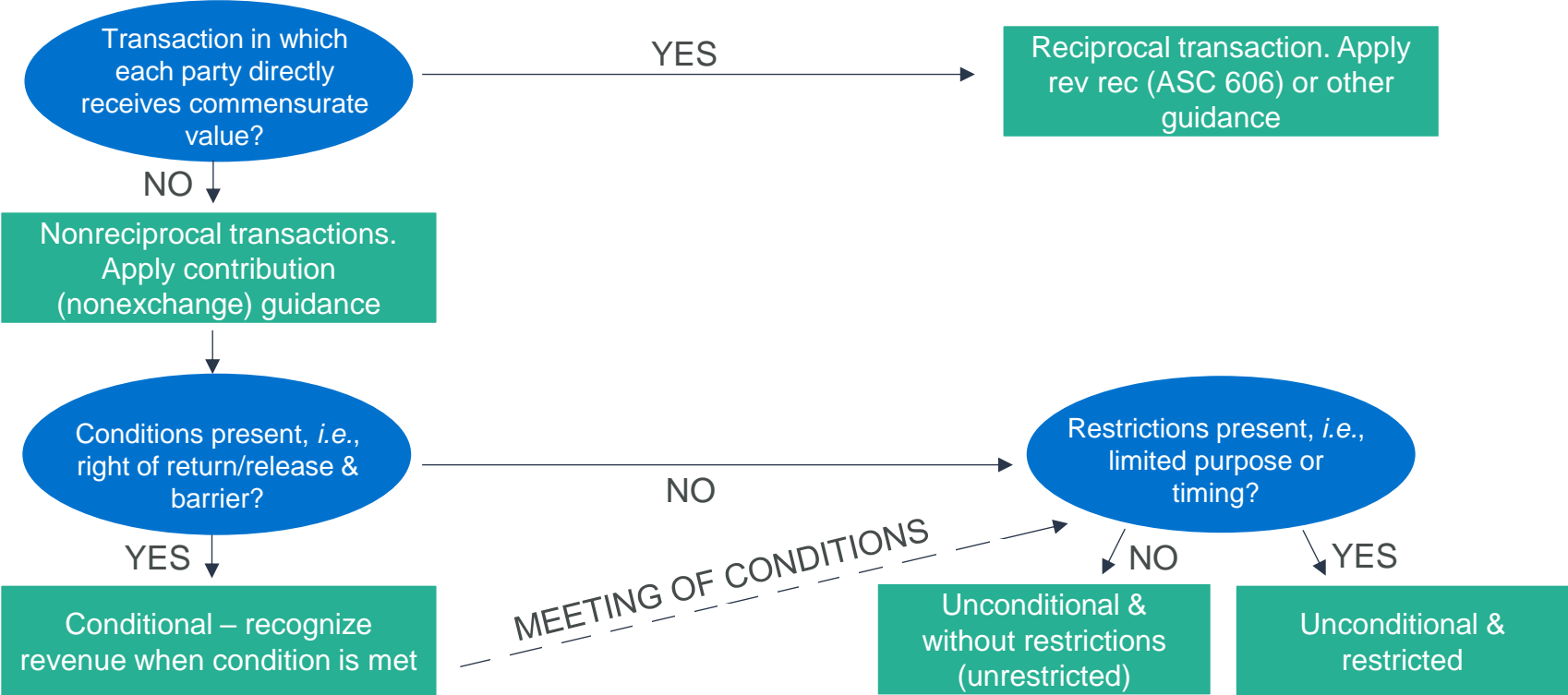
- Indicators of barriers include, but are not limited to:
  - Inclusion of a **measurable** performance-related barrier or other measurable barrier
  - Extent to which a stipulation limits discretion by the recipient on the conduct of an activity
  - Extent to which a stipulation is related to the purpose of the agreement
- Administrative requirements, e.g., reporting or obtaining an audit, is not an example of a condition under the clarified guidance
- In cases of ambiguous donor stipulations – presume conditional

# Right of Return/Release

- The agreement need not have exact wording of right of return/release & could be communicated in another document referenced by the agreement
- Must be a legal right of return
- If not apparent from the agreement whether there is a right of return/release, it is presumed the agreement does not include a right or return/release



# NFP Revenue Recognition Decision Process



# Simultaneous Release Option

- Allows for the NFP to recognize a restricted contribution directly into UR net assets/net assets without donor restriction if restriction is met in same period that the revenue is recognized
- ASU allows for a second & separate election to be made relating to restricted & conditional contributions
- Could have different elections for
  - Restricted/conditional
  - Restricted/other

# Contributions of Nonfinancial Assets



# Why Do We Care?

- Grant applications
- GAAP requirement
- Can help program percentages
- Demonstrates what it costs to run a nonprofit
- Tax requirements
- Receipting IRS requirements
- A way to support nonprofits

# Accounting for Contributed Services – Definition per GAAP

- The majority of nonprofits receive some form of volunteer time, whether it is for direct services in its programs, consultants, vendors or board involvement.
- The value of contributed services must be recognized if the service either:
  - a) creates or enhances assets that are not financial in nature (e.g., buildings, materials, supplies, etc.), or
  - b) requires specialized skills, are provided by individuals with those skills and would typically need to be purchased if the services had not been donated.



## Contributed Services – Common Examples

***NOTE: Common indicators of specialized skills include maintaining a particular license or certification or working with technical tools or artistic talent at a proficiency greater than the general public.***

Common types of contributed services include:

- Architects
- Teachers
- Lawyers
- Accountants
- Bankers
- Investment advisors
- Doctors
- Construction services
- Counselors
- Property maintenance

# Contributions of Nonfinancial Assets

- Recognized if both met
  - NFP recipient has discretion in using or distributing the GIK
  - NFP has risks and rewards of ownership over the GIK
- Recorded as contributions of nonfinancial assets and as expenses or assets

## Contributed Use of Facilities, Utilities, and Other Long-Lived Assets

- Nonprofits should record the entire fair value of the contributed use and not take into account whether they could otherwise afford the asset being used
- NPO's often receive free or discounted use of buildings, telephones, electricity, utilities, or other long-lived assets from the legal owner of the property.
- Recording a pledge receivable for the use of the long-lived assets is often a large asset addition. If not properly identified, you could end up with a significant accounting adjustment resulting in a restatement.

# Gifts of Long-Lived Assets

- Donors may wish to make an outright gift of a long-lived asset where the NPO retains title, such as real estate, vehicles, equipment, works of art, etc.
- Recognized at the asset's fair value at the date of donations (Caution: permanent collection items have different rules for museums, libraries, zoo's, aquariums, historical societies, etc. – ignore these rules for this example).
- Is there a restriction on the long-lived asset? Important to know.

# Bargain Purchases

- Nonprofits often receive significant discounts on purchases they make.
- Some of these transactions may be partly an exchange transaction and partly a contribution, which could be a bargain purchase.
- Bargain purchases result in an inherent contribution, which is a voluntary transfer of assets in exchange for no consideration, or less consideration than the value received.
- Evaluating a bargain purchase can be difficult, but once identified a contribution should be recorded.



# Donated Inventory

- Public radio stations, thrift shops, organizations with vehicle donation programs, or nonprofits that have auctions at special events and galas are just a few types of nonprofits that regularly receive donated goods to be sold.
- When a nonprofit receives donated goods that it plans to subsequently sell, it should record the donated goods at their fair value on the date of the gift as a contribution and inventory.
- Thrift shops, in particular, may find it challenging to value new donated inventory, because so much of what is donated is not saleable and is often discarded or sold in bulk to specialized dealers. (Let's ignore these rules for now for thrift stores)

# Donated Securities

- Donated securities are an effective way for donors to give to nonprofits that fits into their overall personal tax planning.
- Nonprofits that receive donated securities should record a contribution at the fair value of the securities on the date received, or pledged if a nonprofit receives verifiable documentation of committing certain securities before they are actually received.
- Any difference between the value of the pledge and the value of the securities subsequently received would be recorded as an additional contribution or a reduction of contributions.

## Donated Securities (Contributed Financial Assets)

- Many nonprofits have a policy of selling donated securities shortly after receipt, often within a few days.
- Nonprofits should keep in mind that any difference between the proceeds received from the sale of donated securities and the fair value on the date the donated securities were received should be recognized as a realized gain or loss.
- The costs to sell the securities should also be separately recognized as investment fees expense.

# GAAP Reporting of Auctions

- Noncash items are recognized as a contribution at FMV when received.
- Under GAAP, auction proceeds are presumed to equal the fair value of the donated items sold at the auction.
- The organization adjusts the originally recorded contribution amount to equal the auction proceeds.
- Under GAAP, there is no “cost of goods sold” (COGS) for donated auction items.
  - However, under GAAP, donated goods used in raffles or as favors are recorded as part of cost of direct benefits to donors.
- Therefore, the GAAP treatment of noncash items depends on the use of the items.

# GAAP Reporting of Raffles

- Noncash items to be raffled are recognized as a contribution at FMV when received.
- The tickets paid by patrons are a separate transaction and have no relation to the value of the raffled item.



# Objective of ASU 2020-07 Presentation and Disclosures By Not-for-Profit Entities For Contributed Nonfinancial Assets

## Objective

- Increasing transparency about contributed nonfinancial assets through enhancements to presentation & disclosure

## Scope

- Contributions of nonfinancial assets (fixed assets, use of fixed assets, materials & supplies, intangibles, services)

# Not-for-Profit Reporting of Gifts in Kind Requirements of ASU 2020-07

Present	Present contributed nonfinancial assets as separate line item in the statement of activities
Disclose	Disclose disaggregation by category of nonfinancial asset, including whether used or monetized. If used, in which areas/programs. Also, any monetization policies.
Disclose	Disclose a description of donor restrictions associated with nonfinancial asset
Provide	Provide description of the valuation techniques and inputs used to arrive at a fair value measure for contributed nonfinancial assets in accordance with paragraph 820-10-50-2(bbb)(1) of Codification for initial recognition
Disclose	Disclose principal market (or most advantageous market) used to arrive at fair value measure if it is a market in which the recipient NFP is prohibited by donor restrictions from selling or using the contributed asset

# 02

## Leases



# Leases - ASU 2023-01

## Reminders

- Applies to financial and capital leases
- Nonprofits are not exempt
- Discount Rates
- Donated Space
- Related Parties

# 03

## Functional Expenses



# Functional Expenses

- Details expenses spent on programs, general and administrative, membership development and fundraising.
- Ratio analysis of program, G&A and fundraising compared to total expenses. This is how you are typically benchmarked by donors.
- Ratio of overhead to direct program expense
- Ratio of salaries to expenses



# Functional Classification Defined

- Method of grouping expenses according to the purpose for which the costs are incurred
- The primary functional classifications are program services & supporting activities

# Functional Analysis

- Presents an organization's expenses by both natural & functional categories
- Functional categories
  - Program
  - Administrative
  - Fundraising or membership development



# Functional Classifications

## Program Services

- Activities that result in goods/services being distributed to beneficiaries, customers, or members that fulfill the purposes or mission of the organization.
- Those services are the major purpose for and the major output of the organization and often relate to several major programs.
- Keep in mind the accounting standards want us to be able to identify these costs by the top major programs

# Program Services

## Correlates to...

- Fund-raising materials
- Programmatic promotional materials
- Website descriptions
- 990
- Annual reports
- Other public information
- Interrelationships of program expenses and program revenues can help determine major program services
  - Segments
  - Cost Center/Projects/Funds

# Program Services

## Examples

- University: student instruction, research, patient care, other
- Health and Welfare Entity: health or family services, research, disaster relief, public education, other
- Federated Fundraising Entity: making contributions to NFPs
- American Cancer Society: patient support, research, prevention, detection/treatment
- Homeless Shelter: feed the homeless, housing for homeless
- Religious: worship services, youth instruction, adult instruction, family counseling, fellowship

# Functional Classifications

## Management & General

Activities that are not identifiable with a program, fundraising activity or membership-development activity, but are indispensable to the organization

# Functional Classifications

## Fundraising

- Activities that involve inducing potential donors to contribute money, securities, services, materials, facilities, other assets or time
- Includes publicizing & conducting fundraising campaigns, maintaining donor lists, conducting special events, preparing & distributing fundraising materials, etc.
- Financial statements should disclose total fundraising expense

# Expenses vs. Losses

- No requirement to report losses by functional category
- Examples of losses
  - Bad debt – can be either expense or loss
  - Impairment of long-lived assets
  - Change in market value of investments
  - Foreign exchange rates
  - Natural catastrophes
  - Sell of building & equipment
  - Winning/losing a lawsuit

# Functional Expenses

## Expense Allocation

- Allocation of expenses to the organization between program activities and supporting activities
  - Direct allocation/identification – expenses specifically attributable/identifiable to a program or support activity
    - Program manager who spends all their time on the program they manage
  - Indirect cost allocation – method for allocating expenses which are not specifically attributable to a program or support activity
    - Depreciation expense, Executive Director's salary
    - Common allocation methods
      - Estimation of time spent on each functional category
      - Percentage of total salary expense
      - Square footage occupied

# Financial Reporting Requirements

## Joint Activity

- FASB ASC Master Glossary defines a joint activity as “an activity that is part of the fundraising function & has elements of one or more other functions, such as program, management & general, membership development or any other functional category used by the entity.”
- Membership development activities of not-for-profit entities often may be conducted in conjunction with other activities. In circumstances in which membership development is in part soliciting membership dues & in part soliciting contributions, the activity is a joint activity.



# Financial Reporting

## Joint Costs

- Joint costs are the costs of conducting joint activities that are not identifiable with a particular component of the activity. Joint costs may include, but are not limited to, the following:
  - Salaries, contract labor
  - Consultants, professional fees, legal fees, accounting fees
  - Paper, supplies, printing, postage
  - Event advertising
  - Telephones, utilities
  - Depreciation
  - Airtime, websites, print advertising, brochures
  - Facility rentals

# Substantiating Allocations

- Organizations should maintain documentation supporting:
  - Allocation methodology
  - Calculations used to do the actual allocation & to support disclosures in the financial statements
  - Basis of calculations, *e.g.*, time studies with signed timecards, head count of FTEs by department/function, square footage of a shared facility & each functional area within the facility, etc.

# Substantiating Allocations

- Organization should maintain documentation supporting:
  - Reasonableness of the allocations: may include industry information/comparables, trend information for prior years & analysis of this information with respect to current-year allocations
  - Support for the original transactions that make up the expenses that are allocated
  - Use of consistent methodology during the period & from year to year
  - Internal controls surrounding expense allocation process

# Common Issues in Functional Reporting in Financial Statement

Most common errors in allocating costs include:

- Not properly allocating management/general expenses
- Reporting no fundraising expenses when the organization has substantial contribution income
- Not reporting all major programs separately or reporting a grantor as a program
- Not allocating insurance, occupancy & depreciation

# Common Issues in Functional Reporting in Financial Statement

- Difficulty maintaining general ledger on a functional basis, particularly overhead costs
- Difficulty maintaining requirements of grants versus GAAP
- Establish a means of tracking separately & then allocating management & general costs to various cost centers based on a percentage of staff time charged to a particular cost center or some other reasonable method
- Use of a fixed percentage to allocate costs rather than a basis more accurately representing true cost allocations
- Financial reports that are not truly representative of the related functions

# 04

## Endowment Accounting



# Donor Restricted Endowment Fund

When classifying net asset classes consider the donor's explicit stipulations and the applicable laws that extend donor restrictions.



Since there is a requirement to appropriate for expenditure, the funds are time-restricted until that appropriation takes place.



If the fund is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) it extends a donor's restriction to use of the funds. This includes the corpus and the investment return until the funds are appropriated for expenditure by the governing board.

# Board-Designated Endowment Fund

Funds without any purpose-type restrictions.

The original fund and all investment returns are free of donor restrictions.

Reported in net assets without donor restrictions.

Set up by the Board.

NOT subject to an enacted version of UPMIFA.

NOT subject to underwater disclosure requirements.



# How Should a NFP Report the Income from Endowments?

Earnings from endowments are included in the statement of activities in the same net asset class as the related investments.

- Net Assets with donor restrictions – all earnings on donor endowments
- Net Assets without donor restrictions – all earnings on board designated endowments
- Endowment funds typically are tracked by assigning units which allow the investment income/return to be allocated

Accounting policy election on “simultaneous release”. You can report restricted investment income as part of without donor restrictions if the investment income has been appropriated and spent if you have a similar election for contributions. See 958-225-45-6.

# Accounting for Donor Endowments with an Enacted Version of UPMIFA

The original gifted amount, additional gifts, and investment returns should initially be classified as net assets with donor restrictions.

Donors may provide specific instructions on spending from a donor-restricted endowment fund.

When an appropriation is recorded, the amount of net assets with donor restrictions are transferred to net assets without donor restrictions, utilizing the release from restrictions category. The restriction expires as long as all time restrictions have lapsed, and all-purpose restrictions have been met.

If restrictions have not lapsed, you wait to transfer the net assets to without donor restrictions until all the restrictions have been satisfied.

The Board can plan and budget for future appropriations. However, the appropriations are not recorded as a reduction of the endowment and net assets with donor restrictions until the year which the funds are intended to be spent. Operating appropriations are typically defined in the budget and released in equal amounts throughout the period the budget relates to.

There could also be special appropriations beyond the typical annual approvals for things like capital projects, liquidity needs, etc. as long as you stay within the appropriation percentage amounts permitted by law.

# Underwater Endowment Fund

A donor-restricted endowment fund with a fair value at the reporting date that is less than either the original gift amount or the amount required to be maintained by the donor or by law.

Accumulated losses should be included in net assets with donor restrictions.

Disclosures per 958-205-50-2:

- A. The fair value of the fund
- B. The original endowment gift amount or level required to be maintained by donor stipulations or by law that extends donor restrictions
- C. The amount of the deficiencies of the underwater endowment funds (A – B)

During the creation of FASB's ASU 2016-14 the Attorney General/State Charity offices had voiced concern that underwater funds still need to be tracked by the nonprofit and they expressed concern that enacted versions of UPMIFA gave a false belief that since you could spend if you are underwater that you no longer needed to track underwater amounts. Those that were spoken to seemed relieved at this requirement.

**Questions?**

# Contact

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