

Advanced Accounting

ACC400

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Writing Assignments

Research Paper

Accounting for not-for-profit Organizations

“A Case Study of American Red Cross”

by

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Nonprofit organizations (NPOs) are different from corporations for profit in many respects such as practices, accounting, and financial statements. By this, we should keep in mind that nonprofit organizations have as a primary goal to provide socially desirable help to people in accordance with the organizations' social missions and principles. Nonprofit organizations exist in a variety of forms and serve different kinds of sectors, such as religion, education, health, art, environment, and social services. Nonprofit entities do not focus on profit through maximizing stockholders' value and equity or even make a profit through trading transactions like commercial corporations do. NPOs get financed through donations and government programs. This causes accounting for NPOs to become an increasingly interesting topic in the accounting field. Since nonprofit organizations have no profit and are funded directly from donors or contributors, this makes NPOs incur great amounts of expenditures when they provide assistance to help people. The dissimilarity of the main goals of nonprofit and profit organizations helps us to differentiate between nonprofit and profit organization in many ways including accounting requirements and treatments.

In this research paper, I will discuss accounting for nonprofit organizations and financial statements required by the Financial Accounting Standards Board (FASB) as well as illustrate a real practice of accounting for nonprofit organization with a case study of American Red Cross and an example of its accounting practices.

The main areas of accounting for nonprofit organizations include their accounting overviews and methods. NPOs do not have owners and mainly rely on revenues from contributions, donations, and grants to provide assistance for the organizations' social activities.

Due to nonprofit organizations' unique missions for addressing needs of society, accounting regulations require them to issue a statement of activities instead of the income statement issued by profit entities. In general, profit entities' goals are eventually to increase revenues, reduce costs, and measure their profitability, while nonprofit organizations' goal is to run charitable activities relating to their objective and mission. Henke (1983) writes, "financial reports for nonprofit organizations should reflect the service story of the entity, rather than net income or net loss realized by the entity. In sharp contrast, accounting reports for profit enterprises must emphasize the extent of achievement of the profit objective and the ability of the entity to support itself."¹

Accounting for NPOs have methods such as fund accounting, interfund transfer, appropriations, and contributions. NPOs' financial statements are: statement of financial position, statement of activities, statement of functional expenses, and statement of cash flows.

Fund accounting is a method of segregating resources into categories, identifying both the source of funds and the use of funds, which is distributed to accurately represent financial transactions of nonprofit organizations (Herzlinger & Sherman,1980)². Fund accounting allows NPOs to set up account for funds received while to post specific fund given to match with a particular activity or project. This method also enables NPOs to use funds on hand to create a variety of the separated accounts regarding on funds' restriction. This helps NPOs to organize funds, recognize expenditure, and classify funds effectively into their categories in financial statements. Interfund transfers and appropriations are parts of fund accounting. The transactions of interfund transfers are used to allocate resources between funds. Appropriations are applied to

¹ Henke, E.O. (1983): Accounting for Nonprofit Organizations. Massachusetts: Kent Publishing company, Boston.

² Herzlinger, R.E. and Sherman, H.D. (1980): Advantages of fund accounting in „nonprofits“. Harvard Business Review, May-June, p.94-105.

identify and authorize for the future expenditures regarding to the specific purpose of spending. Those two accounts add complexity into nonprofit organizations' financial statements.

Contributions are a significant source of funds in nonprofit organizations. NPOs depend on contributions to operate their missions. FASB defines a contribution as “an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner” (FASB, 1993, p.5)³ and there are a wide range of restrictions attached to them. Contributions can be cash or noncash, including land, equipment, building, or other supplies. The specific purposes of contributions are recorded, along with the correct time and any restrictions specified by the donor.

The FASB requires NPOs to provide a truthful presentations of the entities' information related to donors, contributors, or interested parties who use nonprofit organizations' financial statements. NPOs are required to issue financial statements that fully express the organizations' true position and the nature of services. We have learned some accounting technical words and definitions and the requirements for nonprofit organizations. A case study of the American Red Cross will help to deepen our knowledge f nonprofit organizations' accounting practices and requirements.

The American Red Cross was founded in 1881. The objectives of American Red Cross are to provide services to members of American armed forces and their families as well as to provide a charitable support in case of disasters. The organization's missions are also to prevent human suffering form emergencies. The overall legal values of American Red Cross are to protect human life and health, to ensure respect for human being without any discrimination

³ Financial Accounting Standards Board. (1993). Statement of Financial Accounting Standards No.116: Accounting for Contributions Received and Contributions Made. Connecticut, USA. Retrieved from <http://www.fasb.org/resources/ccurl/770/425/fas116.pdf>

based on nationality, race, religious, belief, and class. The American Red Cross receives financial support from voluntary public contributions and works closely with federal government.

The detail of consolidated financial statements of the American Red Cross are published on the organization's website in accordance with accounting standard of US GAAP and legislation of accounting rules of the United States of America. The trustees are responsible for preparing consolidated financial statements of organization annually by respecting acceptable accounting principle in accordance with US accounting regulation. In addition, the board of trustees have obligation to follow the legislative and accounting requirement for disclosing the charitable objectives and the purpose of providing assistance to the public.

Funding accounting is applied to the American Red Cross accounting. Funds include general unrestricted funds, which those funds are available for use at the option of the trustees in facilitate and support the common charitable objectives. For instance, budget for emergency responses during American Red Cross charitable activities usually categorizes as the unrestricted funds. The pension reserves incorporate with unrestricted funds and are used to meet the pension deficit. Designated funds are classified as the unrestricted funds, which those funds are transferred from the unrestricted funds and are used to support organization's specific purposes at the discretion of trustees. Designated funds need to be plan and authorized by the trustees before the fiscal year end so that these funds can meet organizations' specific future objectives. Also, assertions of accounting estimation for calculating the level of designated funds are reconciled in accordance with the date of approval of designated funds' accounts. Restricted funds are categories into temporarily and permanently restricted funds. The funds are restricted in nature because the funds are used only for specific purposes in accordance of donors imposed

restriction on their contribution. For example, American Red Cross Nepal earthquake response expenses and commitments have raised above \$ 44 million as of April 25, 2017, which some of funds are classified as temporarily and permanently restricted net asset regarding to donors restricted their contribution⁴. Those funds are mentioned in consolidated statement of activities. In the American Red Cross consolidated financial statements, contributed services, investment, and long-lived assets are revaluated and reported at fair value, and are in accordance with the accounting and reporting standard of US GAAP requirement (KPMG, 2015, p. 9)⁵. The 2015 annual reports of the American Red Cross such as: consolidated statement of financial position, consolidated balance sheet and consolidated cash flow statement are provided in the next page of this search paper.

Accounting for nonprofit organization is unique and different from profit organization in many ways, including accounting treatments and requirements, which those help to facilitate the true position of organizations. The organization's financial statements and footnotes will help organizations to truthful disclose the use of their resources and methods. Funding account provides a great detail on how organization is carrying out their funds and use those available funds to run the organizations' missions. All funds and contributions are published in the statement of financial position. Also, the case study of the American Red Cross has provided knowledge of nonprofit organization's accounting and reporting standards requirements that those will deepen our understanding of accounting for nonprofit organization and its practices.

⁴ American Red Cross. (2016). 2016 Annual Report: Bringing Communities Hope. Retrieved from http://www.redcross.org/images/MEDIA_CustomProductCatalog/m64340273_Annual-Report-2016.pdf

⁵ KPMG. (2015). The American National Red Cross: Consolidated Financial Statements. Retrieved from http://www.redcross.org/images/MEDIA_CustomProductCatalog/m56240343_2015_TheAmericanNationalRedCross_CFS.PDF

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