Complicated Contributions and What to Do With Them

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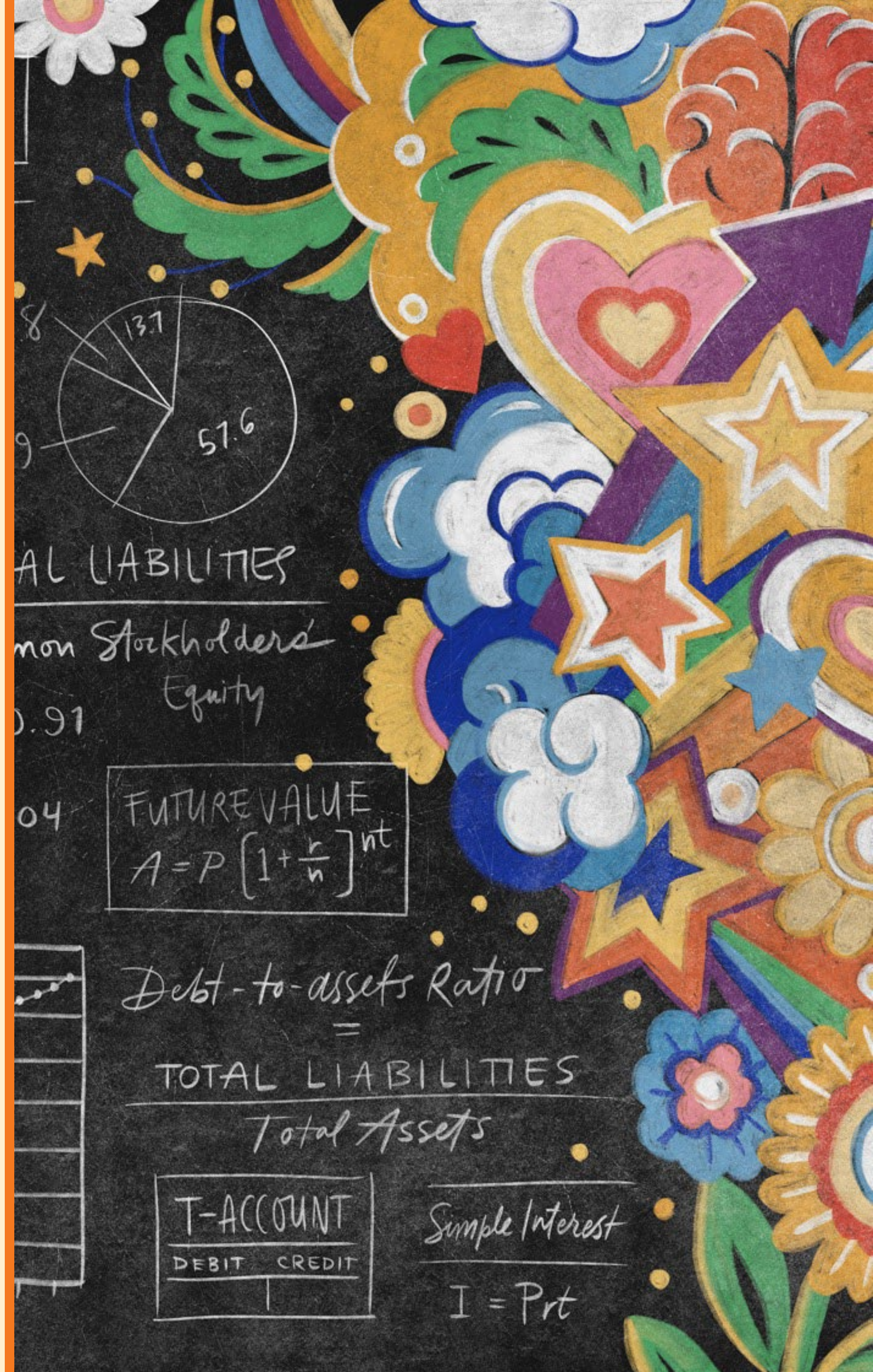

Today’s learning objectives

Learn to identify unique features that impact the accounting for contributions received

What questions to ask a nonprofit’s fundraising department in order to understand certain contributions

Record Complicated Contributions in accordance with GAAP.

Agenda

Introduction

Even Common Contributions Can Be Complicated

CLATS, CLUTS, CRATS, CRUTS, CGAs (Split-interest agreements)

New fundraising strategies & accounting considerations

Introduction

A few observations

- As accountants, many of the mistakes that are made regarding contributions occur because we are not seeing information we need to make decisions about the nature and treatment of the contribution.
- As accountants and business leaders: when there is not adequate communication between our fundraising/development departments, there is an increased risk that we will not get the information we need to make correct accounting decisions.
- As professionals, we need to have confidence that we can handle complicated transactions.
- My goal today is to help increase clarity around contributions, and to increase confidence!

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Icebreaker (polling question #1)

What is the most challenging part of contribution accounting you face?

- A) Properly identifying conditions within a contribution
- B) Properly identifying restrictions related to a contribution
- C) I don't feel challenged most of the time
- D) Situations where fair value needs to be determined

Even Common Contributions that Can Be Complicated

Conditional versus Unconditional Contributions

- What do we see in a conditional contribution?
  - A donor stipulation (donors include other types of contributors, including makers of certain grants) that represents a barrier that must be overcome before the recipient is entitled to the assets transferred or promised.
  - Failure to overcome the barrier/s gives the contributor a right of return of the assets it has transferred or gives the promisor a right of release from its obligation to transfer its assets.

Conditional versus Unconditional Contributions (Continued)

Indicators include:

- A measurable performance-related barrier or other measurable barrier
- Stipulations that limit discretion by the recipient on the conduct of an activity
- Whether a stipulation is related to the purpose of the agreement
- Generally, excludes administrative tasks and trivial stipulations

Conditional Contribution Example

- The Foundation gives the Charity a grant in the amount of $400,000 to provide specific career training to disabled veterans. The grant requires the Charity to provide training to at least 8,000 disabled veterans during the next fiscal year (2,000 during each quarter), with specific minimum targets that must be met each quarter. The Foundation specifies a right of release from the obligation in the agreement that it will only give the Charity $100,000 each quarter if the Charity demonstrates that those services have been provided to at least 2,000 disabled veterans during the quarter.

Polling question #2

A Foundation gives an annual grant of $150,000 to a Charity that requires quarterly reporting on how the funds were used and significant challenges and successes the Charity has experienced. Does the quarterly reporting requirement create a barrier?

- A.) Yes
- B.) No
- C.) Only in certain states
- D.) I don't know

Conditional contributions

"We expect that all funds will be expended by the end of each grant period. If in the event that there are any unexpended funds remaining between grant periods or at the end of the grant period, the Foundation may at its absolute discretion: a.) deduct the unspent funds from the next year's payment; b.) allow the Grantee a no-cost extension of such funds; or c.) require that the Grantee return to the Foundation any Grant funds that remain unspent at the end of the grant term.

The Grantee and the Foundation acknowledge that payments made under this Grant constitute conditional contributions within the meaning of Accounting Standards Update 2018-08 until barriers are overcome and Grantee has no right of return of assets or the obligation to transfer assets."

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ASC 958-605-25-5E

Determining whether a contribution is conditional can be difficult if it contains donor stipulations that do not clearly state whether both:

One or more barriers exist

The right to receive or retain payment or delivery of the promised assets depends on meeting those barriers.

In cases of ambiguous donor stipulations, a contribution containing stipulations that are not clearly unconditional shall be presumed to be a conditional contribution.

Practical considerations

Make sure you have a copy of the grant agreement!

Read the agreement and look for the signs: is there a “right of return”? are there “barriers”?

Search for terms like condition or conditional

Remember that conditional contributions need to be disclosed; this requirement has not changed.

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Promises to give

It is often difficult to determine whether a donor communication is an intention or a promise.

There is a difference between “legally enforceable” and an organization's intention to pursue collectibility using legal means. Legal enforceability refers to the availability of legal remedies.

Consequently, even if the donor's communication does not clearly indicate that it is a promise, FASB ASC 958-605-25-9 notes that an intention to give that is unconditional and legally enforceable should still be considered an unconditional promise to give.

Therefore, if it is unclear whether the words express an intention or a promise, an unconditional promise to give is recognized when the donor's communication is legally enforceable, even if the organization will not use legal means to collect the promised gift.

Although not always conclusive, the following represent a few factors that may indicate an organization has received an intention to give rather than a promise to give:

Do they use words like “intend,” “plan,” “may,” “hope,” or “if expected.”

Is there clear written evidence? A promise can be oral, but if a donor refuses to put communication in writing, that might be evidence of an intention rather than a promise.

Are they making any payments on the promise to give?

As the accountants, we might know these things- but do our fundraising and development people know this information?

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Intentions to give (bequests)

- Bequests-
  - An example of an intention to give is a communication that an organization has been included as a beneficiary in the donor's will. Because the donor can modify the will during his or her lifetime, the communication represents only an intention to give.
  - When the donor eventually dies and the will is declared valid, the intention to give becomes an unconditional promise to give. Accordingly, it is recognized as a contribution at that time.

Initial recognition and measurement

Conditional promises to give	Unconditional promises to give	Intentions to Give
Recognize as contribution revenue and receivable when conditions are substantially met or waived Recognized when conditions are met	Recognize as asset, decrease of liabilities, or an expense, and revenue or gain in the period the unconditional promise is received Generally, use fair value measurement If expected to receive within one year, can use net realizable value	Don’t recognize

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Contributed nonfinancial assets

Gifts in kind should be measured at fair value if they can be used or sold

They should be valued at the price that would be received to sell the asset or transfer a liability in the open market at the date when it is measured.

- Example: Expired dog food is worth less even if it is still "usable".
- Example of impaired value- clothing that is culturally inappropriate in other areas
- Despite the fact that valuation of gifts-in-kind can be challenging, that is not a reason for not making a good faith estimate of fair value. The only GAAP exception to recognizing the value of a gift-in-kind is if there is a major uncertainty of the existence of value

Polling question #3

A charity had volunteers visit their facilities and help paint rooms that are used as accommodations for individuals who are currently homeless. The labor did not require significant skill level, and the charity's staff would have painted the rooms themselves instead of hiring a painter, had there been no volunteers. How should the volunteer labor be recognized?

- A.) It will be noted in the annual report used for fundraising purposes, but it will not be recorded as a contributed service
- B.) It will be recorded at fair value based on average costs for a painter on Google searches
- C.) It will be independently appraised to determine the fair value of the contribution
- D.) Management will make a reasonable estimate of the fair value based on their experience and record a contribution.

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Questions and answers about contributed nonfinancial assets

ASU 2020-07

- Present as a separate line item in the Statement of Activities, apart from contributions of cash and other financial assets
- Disclose what makes up your contributed nonfinancial assets and describe the valuation techniques used.

Consider gift acceptance policies and best practices

- (https://accordnetwork.org/principles)
- IRS considerations- donor acknowledgement, Form 8282/Form 8283

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Practice aid
AICPA
Accounting for and auditing of digital assets
as of July 31, 2023

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Other complicated nonfinancial contributions

Pharmaceuticals

- In determining the principal market, the Audit Guide states that an organization would not look to retail pharmacy sales prices for valuing those gifts in kind unless it was able to sell in that market. Most nonprofit organizations (other than healthcare organizations) do not have the proper licenses, controlled substances registrations, and facilities needed to access that market, and it would not be financially feasible to obtain them. Thus, for those entities, retail prices would not be appropriate for measuring fair value. However, the authors believe that retail prices might be useful to serve as an upper limit for a fair value measurement.

Split-interest agreements

Terms and definitions

- *Lead Interest.* A lead interest is the right to the benefit of the transferred assets (either cash flows or use of the asset) that generally begins when the split-interest agreement is signed and terminates at a specified future time. That specified time can be expressed as a term of years or upon the occurrence of a certain event, such as the death of the lead interest beneficiary.

- *Remainder Interest.* A remainder interest is the right to the remaining assets at the termination date specified in the agreement.

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Types of split-interest agreements

Characteristics of Split-interest agreements					
Type	3rd Party Trustee?	Lead interest	Remainder interest	Payout	Payout obligation
Charitable lead annuity trust	Possible	Nonprofit	Noncharitable beneficiary	Sum certain	Trust
Charitable lead unitrust	Possible	Nonprofit	Noncharitable beneficiary	Fixed percentage	Trust
Charitable remainder annuity trust	Possible	Noncharitable beneficiary	Nonprofit	Sum certain	Trust
Charitable remainder unitrust	Possible	Noncharitable beneficiary	Nonprofit	Fixed percentage	Trust
Charitable gift annuity	No	Noncharitable beneficiary	Nonprofit	Sum certain	Nonprofit
Pooled (life) income fund	No	Noncharitable beneficiary	Nonprofit	Actual income	Trust

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Journal entries for Split-interest gift

Trust type	Third Party Holds the Assets	Organization Holds the Assets
Revocable agreement	No entries	Debit: Assets held in revocable agreement Credit: Refundable advance
Charitable Lead Annuity Trust	Debit: Beneficial interest in lead trust Credit: Contribution revenue	Debit: Assets held in charitable lead trust Credit: Liability for amounts held by others Credit: Contribution revenue
Charitable Lead Unitrust	Debit: Beneficial interest in lead trust Credit: Contribution revenue	Debit: Assets held in charitable lead trust Credit: Liability for amounts held by others Credit: Contribution revenue
Charitable Remainder Annuity Trust	Debit: Beneficial interest in remainder trust Credit: Contribution revenue	Debit: Assets held in charitable remainder trust Credit: Liability for amounts held by others Credit: Contribution revenue
Charitable Remainder Unitrust	Debit: Beneficial interest in remainder trust Credit: Contribution revenue	Debit: Assets held in charitable remainder trust Credit: Liability for amounts held by others Credit: Contribution revenue
Charitable Gift Annuity	N/A- must be held by org	Debit: Assets Credit: Annuity payment liability Credit: Contribution revenue
Pooled (Life) Income Fund	N/A- must be held by org	Debit: Assets of pooled income fund Credit: Discount for future interest (deferred revenue) Credit: Contribution revenue

Fair value measures are used in the following ways when accounting for split-interest gifts:

- To measure the transferred assets of the split-interest agreement if the nonprofit organization serves as trustee or if the assets transferred by the donor are otherwise under the organization's control (e.g., the organization can remove or replace the trustee).
- To initially measure the contribution revenue and lead interest of a charitable lead annuity trust or a charitable lead interest unitrust.
- To initially measure the liability to the noncharitable beneficiary of a charitable remainder annuity trust or a charitable remainder unitrust if the nonprofit organization serves as trustee or if the assets transferred by the donor are otherwise under the organization's control.
- To initially measure the contribution revenue and remainder interest of a charitable remainder annuity trust or a charitable remainder unitrust if a third party serves as the trustee or fiscal agent of the trust.
- To initially measure the liability to the noncharitable beneficiary of a gift annuity agreement.
- To initially measure the contribution revenue of a pooled income fund agreement.
- To subsequently measure the investments of most split-interest agreements if the nonprofit organization serves as trustee or if the assets transferred by the donor are otherwise under the organization's control.
- To subsequently measure the embedded derivative if an agreement contains one

Example: Charitable remainder in a unitrust

Bill Smith establishes a charitable remainder unitrust with assets valued at $200,000, naming Greater Washington Society of CPAs as the charitable beneficiary. The trust agreement specifies that Mr. Smith’s spouse will annually receive 5% of the fair value of the trust assets until her death. Mrs. Smith's life expectancy is 10 years. The trust assets are invested in a balanced portfolio that is expected to return 7% annually. GWSCPA uses present value techniques to determine fair value. Assume the appropriate discount rate for the future annual receipts (a receivable) is 7%.

Calculation for Charitable Remainder in a Unitrust

Year	Projected trust income	Projected payout	Project Fair Value of Trust- End of year
	Assumption- 7% return	***5% annual payout***	
0	$ -	$ -	$ 200,000
1	14,000	10,000	204,000
2	14,280	10,200	208,080
3	14,566	10,404	212,242
4	14,857	10,612	216,486
5	15,154	10,824	220,816
6	15,457	11,041	225,232
7	15,766	11,262	229,737
8	16,082	11,487	234,332
9	16,403	11,717	239,019
10	16,731	11,951	**243,799**

Present value of $243,799 to be received in 10 years:

$243,799 x .50835 = $123,935 (using PV tables)

=PV(7%,10,0,-243799,0) (using excel formulas)

Shortcut- Do the present value of the future value of the trust using the "spread" between income and payout:

=PV(7%,10,0,-(FV(2%,10,0,-200000,0)),0)

Adjustments during the term of the agreement

During the term of a split-interest agreement, an organization will recognize changes in the value of its rights in the split-interest agreement. Changes in the value can result from the following:

- Payments made to the organization.
- Payments made to noncharitable beneficiaries.
- Amortization of the discount established to record the benefits to be received at fair value. (In general, the discount rate should not change after initially recognizing the split-interest agreement)
- Revaluations of the projected future payments to the noncharitable beneficiaries. (Revaluations of projected future payments result from changes in actuarial assumptions, such as changes in the life expectancy of the noncharitable beneficiaries where payments cease upon the death of the payee)
- Investment income, gains and losses.
- Changes in the time value of money.

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Polling question #4

What type of split-interest agreement creates a payout obligation for the nonprofit organization

- A.) Charitable remainder unitrust
- B.) Charitable gift annuity
- C.) Charitable lead annuity trust
- D.) Pooled (life) income fund

Practical considerations

- Make sure you have a copy of the agreement!
- Look for attributes that will help you identify the type of contribution you are dealing with (who gets paid, and when)
- Search for terms like “revocable”, “lead”, “remainder”, etc.
- These are complicated contributions- don’t be afraid to ask others for help.

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Trends to watch in fundraising

Trends to watch in fundraising

- Online auctions
  - Advantages and utility of virtual fundraising
  - Administration can be complex
    - Single event or ongoing?
    - Will a third-party platform be used?

Trends to watch in fundraising

- Text to Donate Campaigns
  - The benefit of "immediacy"
  - Costs, but to the nonprofit and the donor
  - Issues of collectability and recognition

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Trends to watch in fundraising

- QR Codes
  - "Quick response"
  - Importance of user interface
  - Eliminates need for physical payment terminals

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A few final thoughts

Don't go on autopilot- practice accounting with both eyes open and make sure you are maintaining and reading donor communications

Have a cadence for communication with your development department

Remember that they may be looking at things from a different angle than we will as accountants, and they might not always spot the details and attributes that we are concerned about

Don't let math or terminology scare you. Take your time. We are CPAs- you have the smarts, you have the resources, and you have a fantastic community of CPAs around you to help!

Who we are:

We are passionate for what's next! That means we are eager to tackle tomorrow's challenges and opportunities. We can't wait to solve them together.

When people come to work here, they stay for the long haul – our average length of service is seven and a half years. That means our clients and colleagues build lasting relationships and you will always deal with people you know, who know your business.

Our people come from diverse backgrounds and serve clients all over the globe. To extend our international reach, we are members of Morison KSi, a global association of 157 leading professional services firms that span 82 countries. This combination provides clients capabilities other independent CPA firms can't match.

Thank you!

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