

Accounting for Government and Non-profit Organisations

Unit - IV

COURSE CODE – Acct 327

Eighth Semester

Prepared By:

DR MASHARIQUE AHMAD

**Bachelor of Science in Business
Administration (BSBA)**

Unit - IV

Accounting for Non Profit Organizations:

Accounting standards

Issues in colleges and universities,

Unique issues relating to not for profit health care provider i.e., Hospitals and Voluntary Health

And welfare organizations

Learning Objectives

- Understand the unique issues faced by not-for-profit health care providers and colleges and universities (C&U)
- Understand accounting and reporting issues for healthcare providers such as accounting for:
 - Revenues and expenses
 - Fee for service revenues
 - Capitation revenues
 - Bad debts and charity care
 - Malpractice claims
 - “Retrospective” insurance premiums

Learning Objectives (cont'd)

- Understand the reporting options available to government C&U and the differences in financial reporting for government C&U and not-for-profit C&U.
- Discuss accounting and reporting issues for all C&U, such as accounting for
 - Revenues and expenses
 - Tuition and fees
 - Grants
 - Student Loans
 - Special concerns related to auxiliary enterprises
- Journalize transactions and prepare financial statements for governmentally owned C&U.
- Prepare financial statements for private colleges and universities .

Nongovernment Non-business Organizations (NNOs)

Four Major Classifications of NNOs:

1. Nonprofit institutions of higher education.
2. Hospitals and other health care providers.
3. Voluntary health and welfare organizations (VHWOs).
4. Other nongovernment nonbusiness organizations (ONNOs).

Hierarchy of Accounting Standards (NNOs)

First level of priority

- FASB Statements and Interpretations
- AICPA Accounting Research Bulletins

Second level of priority

- FASB Technical Bulletins
- AICPA Industry Audit and Accounting Guides

Third level of priority

- Consensus positions of FASB emerging issues task force
- AICPA Acct Sec Practice Bulletins

Hierarchy of Accounting Standards (NNOs)

Fourth level of priority

- AICPA Accounting Interpretations
- Implementation guides
- Industry practices

Fifth level of priority

- FASB Concept Standards
- Pronouncements of other professional associations or regulatory agencies.
- Other accounting literature.

Accounting Standards (NNOs)

Most guidance for NNOs is found in Audit and Accounting Guides of the AICPA and in publications of industry:

- **Colleges and Universities**
- Audits of Colleges and Universities, 2nd ed. (AICPA, 1975)
- Financial Accounting and Reporting Manual for Higher Education
- **Hospitals and Other Health Care Providers**
- Audits of Providers of Health Care Services (AICPA, 1989)
- **Voluntary Health and Welfare Organizations (VHWOs)**
- Audits of Voluntary Health and Welfare Organizations (AICPA, 1988)
- **Other Nongovernment Nonbusiness Organizations**
- Audits of Certain Nonprofit Organizations, second edition (AICPA, 1987).

Issues related to colleges and University

Recognition of Service Fee Revenue

Operating versus Non-operating Income

Issues relating to Hospital:

Charity care

Contractual Allowances

Capitation revenues

Malpractices

Health Care Organizations, such as Hospitals, can be structured as

**For-Profit:
Proprietary**

**Not-for-Profit:
Voluntary**

**Governmental:
Public**



Examples of Health Care Organizations

- Not-for-Profit: St. Luke's Health System and Memorial Hermann Healthcare system in Houston.
- For-profit: HealthSouth
- Governmental: M.D. Anderson Cancer Center in Houston.

Health Care Organizations (HCOs)

Types of Services:

- Clinics and individual (or group) practices
- Continuing care retirement communities (CCRC)
- Health maintenance organizations (HMOs)
- Home health agencies, e.g., hospice
- Hospitals
- Nursing homes
- Rehabilitation centers

Accounting Issues that differ depending upon the Organizational Structure (Government v/s NFP HCO)

- reporting entity
- contributions
- financial statement display
- cash flows
- deposits and investments
- operating leases
- compensated absences
- debt refunding; risks and uncertainties
- pensions and other post retirement benefits

Financial Statements for HCOs

- Balance Sheet
- Statement of Activities
- Statement of Changes in Net Assets
- Statement of Cash Flows

Fund Accounting (for governmental HCOs or for internal purposes)

For purposes of internal accounting, HCOs have:

- General Unrestricted Funds
 - Reports financial resources and fixed assets.
- Donor-Restricted Funds (both temporarily and permanently restricted):
 - Specific Purpose Fund
 - Plant Replacement and Expansion Fund
 - Endowments

Revenues - HCOs

- Revenues are categorized as:
 - Unrestricted
 - Temporarily restricted, and
 - Permanently restricted
- Unrestricted revenues:
 - Patient care revenues
 - Other revenues

Principle Sources of Revenue for a HCO:

- Patient service revenue
- Premium revenue from capitation fees
(i.e. fixed fees per person paid periodically regardless of services provided)
- Resident service revenue (e.g., maintenance or rental fees)
- Other revenue (e.g., sales, fees, rental of facilities, investment income and gains, unrestricted contributions)
- net assets released from restrictions used for operations (for non-governmental not-for-profit HCOs)

Revenues (cont'd)

- Patient service revenue is reported net of contractual adjustments (i.e., differences between gross charges and the amount to be paid by third party payors).
- Prepaid health care plans that earn revenue from *agreements to provide* service record revenue at the point agreements are made, not when services are rendered.
- Payment often comes from *third-party payors*, Medicare or Blue Cross or private insurance companies according to allowable costs or predetermined (prospective) rates for services.
- Donated services and supplies are reported at their fair value, if material and meet criteria.

Revenues (cont'd)

- Charity service to indigent patients for which payment is never expected is not recorded, but may be reported in the Notes to the Financial Statements.
- Operating income arises from ongoing major activities, such as service revenue.
- Nonoperating income arises from transactions peripheral or incidental to the delivery of health care, such as investment income and unrestricted contributions.

Example 1- Patient Care Revenues

During a particular week a hospital records \$400,000 in patient charges. It estimates that 80% (320,000) of the charges will be billed to third-party payers who will, on average, discount the invoiced amounts by 30% (96,000). The remaining 20% (80,000) of the hospital charges will be billed to patients who are uninsured. Of this 20%, 60% (48,000) will be uncollectible.

Entries:

To record one week's patient revenues:

Patient account receivable	\$400,000
Patient revenues	\$400,000

Practical Question 2- Capitation Fee Revenue

A physician group receives \$300,000 in capitation fees from the Hartford Insurance Company to provide comprehensive health care to members of the company's health plan. During the month it provides services for which it would bill, at standard rates, \$240,000. In addition, it refers patients to hospitals and other health care providers for which it expects to be billed \$18,000.

Entries:

To record capitation fees:

Cash	\$300,000	
Revenue from capitation fees		\$300,000

To record liability for patient referrals:

Patient referrals (expense)	\$18,000	
Obligations for patient referrals		\$18,000

Practical Problems

Example: A hospital values care provided to indigent patients at \$300,000, based on standard billing rates. However, it anticipates collecting none of its services.

Answer: In this case, the hospital need not make any entry to record the value of the charitable care. However, it should explain its policies and report the total value of the care provided in notes to the financial statements.

Expenses

- Reported within the unrestricted category.
- Use full accrual basis of accounting.
- Bad debts is an expense (not a reduction of gross revenue, as it had been in the past).
- Depreciation is recorded on capital assets and reported in the General Fund (for governmental HCOs).
- Classified by function or object. Expenses can be reported by natural classification (e.g., line items such as salaries and supplies) or functional categories, such as inpatient services and fiscal and administrative services.

Commitments and Contingencies

- malpractice claims
- risk contracting
- third-party payor payments
- obligations to provide uncompensated care
- contractual agreements with physicians
- as well as others incurred in any business

Example 4 – Malpractice Claims

Issue: A hospital has been charged with negligence in the death of a patient. Although no claim has yet been filed, past experience indicates that the hospital is almost certain to be sued.

Answer: The hospital would be required to charge an expense (a loss) in the period of the incident only if it were able to make a reasonable estimate of the amount. If unable to estimate the amount, it would be required to disclose the details of the incident. Assuming that the hospital was able to estimate the amount of loss (\$500,000), the following entry will be made:

To record the estimated cost of settling a potential claim:

Anticipated legal claims (expense)	\$500,000	
Commitments and contingencies (liability)		\$500,000

Prepaid Healthcare Plans

- Health maintenance organizations (HMOs) and preferred provider organizations (PPOs) function as brokers between the consumer (patient) demanding the service and the providers of health care (hospitals and health care professionals).
- Accounting issues relate to:
 - Revenue recognition
 - Accounting for risk contracts

Financial and Operational Analysis of HCOs

Decision makers evaluate HCO for different reasons:

- Managers are accountable for performance.
- Financial analysts determine the creditworthiness of organizations issuing debt.
- Third-party payors determine appropriate payment for services.
- Patients assess quality of health care services, such as success rate of certain procedures.

HCO Performance Measures

These measures can be categorized by:

- Patient volume (e.g., occupancy rate or daily census and average length of stay)
- Patient and payout mix (e.g., Medicare, commercial, private pay)
- Productivity and efficiency (e.g., personnel per average daily census)
- Debt covenant ratios

Financial Statements for a Private C&U

- Reporting
- Statement of Financial Position classifying net assets into:
 - unrestricted
 - temporarily restricted
 - permanently restricted
- Statement of Activities
- Statement of Cash Flows
- Example: Rice University

Fund Accounting for College & University

The fund structure prescribed by the AICPA 1973 Audit and Accounting Guide for Colleges and Universities (no longer authoritative for external financial reporting purposes):

- Current funds (unrestricted and restricted)
- Loan funds
- Endowment and similar funds
- Annuity and life income funds
- Plant funds (4 sub-funds)
- Agency funds

Revenue Classifications

- Both governmental and private universities classify revenues by source and expenses by function.
- Common categories of revenue include:
 - Tuition and fees
 - Federal, state, and local appropriations
 - Private gifts
 - Grants and contracts
 - Endowment income
 - Sales and services of educational activities
 - Sales and services of auxiliary activities
 - Gain/loss on sales of investments

C&U - Example 1

The fiscal year of a college ends July 31. In June 2008 a college collects \$6 million in tuition and fees for its summer semester that begins on June 1 and ends on August 15.

It also collects \$9 million for the following fall semester, which begins on September 5th. Faculty salaries applicable to summer session courses are \$500,000. Of this amount, \$400,000 are applicable to June and July and \$100,000 to August.

C&U - Example 1(cont'd)

Following the AICPA guidance, the entire summer semester's tuition and fees, as well as the related faculty salaries, should be recognized in the year ending July 31, 2008.

To record revenue for the summer semester (June 1, 2008):

Cash	\$6 million
Revenue from tuition/fees	\$6 million

To record faculty salaries:

Faculty salaries relating to summer semester (expense)	\$500,000
Cash	\$400,000
Deferred faculty salaries (liability)	\$100,000

C&U - Example 1 (cont'd)

- Following GASB (instead of AICPA):

To recognize revenue:

Cash	\$ 6million
Revenue from tuition/fees	\$4.8 million
Deferred revenues from tuition/fees	\$1.2 million

- Faculty salaries would be divided between the 2 semesters.

To record faculty salaries:

Faculty salaries relating to summer semester (expense)	\$400,000
Cash	\$400,000

C&U - Example 1(cont'd)

Under both FASB and GASB the \$9 million in tuition and fees applicable to the fall semester should be:

- recognized as revenue in the year ending July 31, 2009
- and should be reported as deferred revenue when received in June 2008.

To record tuition and fees applicable to fall semester (Sept 5, 2008):

Cash	\$9 million
Deferred revenue (liability)	\$9 million

C&U - Example 2

In 2008 a private university's accounting department received a \$300,000 federal grant to carry out research in government budgeting. Of this amount, \$180,000 was to cover faculty salaries and \$120,000 was to cover overhead. During 2008 the department began the research and paid faculty members \$45,000. It was reimbursed by the federal government for \$75,000.

C&U - Example 2 (cont'd)

Entries:

To record faculty salaries (unrestricted fund):

Sponsored research—expense	\$45,000	
Cash		\$45,000

To record amount due from federal government for reimbursement of direct/indirect costs:

Due from federal government	\$75,000	
Government grants and contracts— direct reimbursement (revenue)		\$45,000
Government grants/contracts— reimbursement for overhead (revenue)		\$30,000

To record collection of cash from federal government:

Cash	\$75,000	
Due from federal government		\$75,000

Current Operating Expenses

- Recognized on the accrual basis.
- May be classified by:
 - program functions
 - organizational units
 - projects
 - object classes.

Functional Classification of Expenses

- Instruction
- Research
- Public service
- Academic support
- Student services
- Institutional support
- Operation and maintenance of plant
- Scholarships and fellowships

Practical Problem related C&U

Accounting for Board Designated Funds

- Part of current **unrestricted** fund.
- Resources designated by governing board for specific purposes, projects, or investments.
- To limit discretion of management.
- Governing board can modify designations.
- Hospitals = classified as **assets whose use is limited**.

Accounting for Current Funds

Colleges and Universities

- Board designated funds for specific current operating purposes are accounted for by footnote or by reclassification of the Unrestricted Current Fund Balance.
- Some board-restricted current resources can be transferred to other funds.

Accounting for Current Funds

Mandatory and Nonmandatory Transfers

- Unique to colleges and universities
- **Mandatory transfers**
 - Transfers from current funds group to other fund groups arising from
 - binding legal agreements
 - grant agreements
- **Nonmandatory transfers**
 - Transfers from current funds group to other fund groups at **discretion of governing board.**

Contributions

- SFAS No. 116, requires contributions to be recognized as **revenue** in the period received.
- Contributions include gifts of cash, pledges, donated services, and gifts of noncash assets.
- Conditional promises to give are recognized when they become unconditional.
- Pledges are recorded as revenues when a promise to give is nonrevocable and unconditional, at present value of expected receipts.

Contributions

Exercise A well-known celebrity sponsored a telethon for the Help for the Blind Foundation on November 1, 2008. Pledges in the amount of \$1,000,000 were called in. Using similar telethon campaigns as a basis, it is estimated that 25% of the pledges will be uncollectible. During 2009, \$700,000 of contributions from these pledges were collected. The remainder were uncollectible.

Required: Identify the appropriate fund(s) and prepare the journal entries necessary in 2008 and 2009 to record these transactions.

Contributions

Exercise Prepare the journal entries necessary in **2008**.

Pledges Receivable	1,000,000	
Revenue - Contributions		1,000,000
Provision for Uncollectible Pledges	250,000	
Allowance for Uncollectible Pledges		250,000

Contributions

Exercise Prepare the journal entries necessary in **2009**.

Cash	700,000	
Pledges Receivable		700,000
Provision for Uncollectible Pledges	50,000	
Allowance for Uncollectible Pledges	250,000	
Pledges Receivable		300,000

Contributions

Donated Services

Recognized only if the services received:

1. Create or enhance nonfinancial assets, *or*
2.
 - a. Require specialized skills,
 - b. Are provided by individuals possessing those skills, *and*
 - c. Would need to be purchased if not provided by donation.

Recorded as revenue or support with an amount equal to the revenue recognized as an expense in the appropriate expense account.

Contributions

Exercise During 2008 volunteer pinstripers donated their services to General Hospital at no cost. The staff at General Hospital was in control of the pinstripers' duties. If regular employees had provided the services rendered by the volunteers, their salaries would have totaled \$6,000. While working for the hospital, the pinstripers received complimentary meals from the cafeteria, which normally would have cost \$500.

Required: Prepare the journal entry necessary in the General Fund to record the donated services on the books of General Hospital.

General Services Expense	5,500	
Donated Services (Nonoperating Revenue)		5,500

Contributions

Donor-imposed Restricted Contributions

Recorded as contribution revenues in period received, thus increasing either temporarily or permanently restricted net assets.

When expenditures are made, or restriction expires, net assets are reported as unrestricted net assets on the Statement of Activities.

Contributions

Exercise The Franklin Public Library received a restricted contribution of \$300,000 in 2008. The donor specified that the money must be used to acquire books of poetry written in the sixteenth century. As of December 31, 2008, only \$100,000 of the restricted resources had been expended.

Required: Prepare the journal entries necessary to record these events during 2008. Indicate the fund in which each journal entry is recorded.

Contributions

Exercise Prepare the journal entries necessary to record these events during 2008.

Restricted Current Fund

Cash	300,000	
Contribution Revenue – Poetry Collection		300,000
Net Assets Released from Restrictions	100,000	
Cash		100,000

Unrestricted Current Fund

Cash	100,000	
Net Assets Released from Restrictions		100,000
Expenses – Poetry Collection	100,000	
Cash		100,000

Quiz- 4

1. Which one is not part of Non Profit Organization:

- (a) Nonprofit institutions of higher education. (b) Hospitals and other health care providers.
- (c) Voluntary health and welfare organizations (d) Other nongovernment non-business organizations.
- (e) Private company

2. Tuition fees collected from students is considered is as: Select right answer

- (a) Revenue (b) Assets (c) Liability

3. What do you mean by voluntary organization:

- (a) Meant for social services, (b) Association of person
- (c) Colleges and Universities, (d) All of the above

4. Government university to report state appropriation as

- (a) Operating revenue, (b) Non Operating revenue, (c) Non capital revenue,
- (d) Special revenue

5. Which of the following expenses would least likely be a line item on the statement of activities of a not for profit college.

- (a) Instruction, (b) Salaries & wages, (c) auxiliary enterprises, (d) Student services

True and False:

5. Religious Trust is not a part of Not for Profit Organization.

- (a) True (b) False

6. The absence of profit motive, is the nature of Not for Profit Organization?

- (a) True (b) False

7. Do you think that the Not for Profit Organization helps to the poor people only.

- (a) True (b) False

8. Fund is compulsory part of any organization

(a) True (b) False

9. Is permanent fund exists in Trusts/ Religious organization?

(a) True (b) False

Fill in the blank:

10. The major sources of fund in hospital

.

HOME ASSIGNMENT

Q-1.

Describe the unique issues faced by Universities

Q-2.

Explain The Meaning And purposes of Voluntary organization, Name of any three in the Kingdom

Questions

Q-1. A well-known celebrity sponsored a telethon for the Help for the Blind Foundation on November 1, 2008. Pledges in the amount of \$1,000,000 were called in. Using similar telethon campaigns as a basis, it is estimated that 25% of the pledges will be uncollectible. During 2009, \$700,000 of contributions from these pledges were collected. The remainder were uncollectible.

Required: Identify the appropriate fund(s) and prepare the journal entries necessary in 2008 to record these transactions.

Cont....

Question

Prepare the journal entries necessary to record these events during 2008.

Restricted Current Fund

Cash	300,000	
Contribution Revenue – Collection		300,000
Net Assets Released from Restrictions	100,000	
Cash		100,000

Unrestricted Current Fund

Cash	100,000	
Net Assets Released from Restrictions		100,000
Expenses – Collection	100,000	
Cash		100,000

Questions

Q-2. A hospital values care provided to indigent patients at \$300,000, based on standard billing rates. However, it anticipates collecting none of its services.

Ans. In this case, the hospital need not make any entry to record the value of the charitable care. However, it should explain its policies and report the total value of the care provided in notes to the financial statements.

Questions

Q-3. A well-known celebrity sponsored a telethon for the Help for the Blind Foundation on November 1, 2008. Pledges in the amount of \$1,000,000 were called in. Using similar telethon campaigns as a basis, it is estimated that 25% of the pledges will be uncollectible. During 2009, \$700,000 of contributions from these pledges were collected. The remainder were uncollectible.

Required: Identify the appropriate fund(s) and prepare the journal entries necessary in 2008 and 2009 to record these transactions.

Ans. Prepare the journal entries necessary in 2008.

Pledges Receivable	1,000,000	
Revenue - Contributions		1,000,000
Provision for Uncollectible Pledges	250,000	
Allowance for Uncollectible Pledges		250,000

Ans. Prepare the journal entries necessary in **2009**.

Cash	700,000	
Pledges Receivable		700,000
Provision for Uncollectible Pledges	50,000	
Allowance for Uncollectible Pledges	250,000	
Pledges Receivable		300,000

Question

Q- 4. In 2008 a private university's accounting department received a \$300,000 government grant to carry out research, in government budgeting out of this amount, \$180,000 was to cover faculty salaries and \$120,000 was to cover overhead. During 2008 the department began the research and paid faculty members \$45,000. It was reimbursed by the government for \$75,000. Recognize the expenses and pass necessary journal entries.

Answer- Q. 4

Entries:

To record faculty salaries (unrestricted fund):

Sponsored research—expense	\$45,000	
Cash		\$45,000

To record amount due from government for reimbursement of direct/indirect costs:

Due from government	\$75,000	
Government grants and contracts— direct reimbursement (revenue)		\$45,000
Government grants/contracts— reimbursement for overhead (revenue)		\$30,000

To record collection of cash from government:

Cash	\$75,000	
Due from government		\$75,000

Question

Q-5. A hospital has been charged with negligence in the death of a patient. Although no claim has yet been filed, past experience indicates that the hospital is almost certain to be sued.

Ans. The hospital would be required to charge an expense (a loss) in the period of the incident only if it were able to make a reasonable estimate of the amount. If unable to estimate the amount, it would be required to disclose the details of the incident. Assuming that the hospital was able to estimate the amount of loss (\$800,000), the following entry will be made:

To record the estimated cost of settling a potential claim:

Anticipated legal claims (expense)	\$800,000	
Commitments and contingencies (liability)		\$800,000

Question

Q-6. The fiscal year of a college ends July 31. In June 2008 a college collects \$6 million in tuition and fees for its summer semester that begins on June 1 and ends on August 15.

It also collects \$9 million for the following fall semester, which begins on September 5th. Faculty salaries applicable to summer session courses are \$500,000. Of this amount, \$400,000 are applicable to June and July and \$100,000 to August.

Following the AICPA guidance, the entire summer semester's tuition and fees, as well as the related faculty salaries, should be recognized in the year ending July 31, 2008.

To record revenue for the summer semester (June 1, 2008):

Cash	\$6 million
Revenue from tuition/fees	\$6 million

To record faculty salaries:

Faculty salaries relating to summer semester (expense)	\$500,000	
Cash		\$400,000
Deferred faculty salaries (liability)		\$100,000

-
-
- Following GASB (instead of AICPA):

To recognize revenue:

Cash	\$ 6million	
Revenue from tuition/fees		\$4.8 million
Deferred revenues from tuition/fees	\$1.2 million	

- Faculty salaries would be divided between the 2 semesters.

To record faculty salaries:

Faculty salaries relating to summer semester (expense)	\$400,000	
Cash		\$400,000

C&U - Example 1(cont'd)

Under both FASB and GASB the \$9 million in tuition and fees applicable to the fall semester should be:

- recognized as revenue in the year ending July 31, 2009
- and should be reported as deferred revenue when received in June 2008.

To record tuition and fees applicable to fall semester (Sept 5, 2008):

Cash	\$9 million
Deferred revenue (liability)	\$9 million

Questions

7. Describe the accounting standard used in non profit organization.

Objective type question:

8. What do you mean by voluntary organization:

- a) Meant for social services, b) Association of person
- c) Colleges and Universities, d) **All of the above**

9. Government university to report state appropriation as

- a) **Operating revenue**, b) Non Operating revenue, c) Non capital revenue,
- d) Special revenue

10. Which of the following expenses would least likely be a line item on the statement of activities of a not for profit college.

- a) Instruction, b) Salaries & wages, c) auxiliary enterprises, d) **Student services**