



Financial Reporting in a Weak Economy



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The weak economy has resulted in the perfect storm for the nonprofit community. Sources of revenue including contributions, fees, government funding, corporate donations, foundation grants and investment income are all lower and are unlikely to rebound until next year. At the same time the demand for services, particularly social services, is high.

As you face this storm, here are some of the key financial reporting issues you should consider in preparing your monthly and year-end financial statements in a weak economy. The issues noted below are not a comprehensive listing of all components of your financials that are impacted by our weak economy, but hopefully they will serve as a good starting point for you.

Receivables and Allowances for Uncollectible Amounts

Receivables should be reported at their net realizable value (net amount expected to be collected) at any given balance sheet date. With a weak economy comes an increased chance that individuals and organizations will fail to pay amounts they owe you. Most organizations have established allowances for uncollectible amounts against accounts receivable, pledges receivable, and notes receivable. These allowances are typically computed based on past collection history with different types of customers and donors. However, these allowance calculations should now be revisited to ensure they are adequate given the fact that past history is likely not adequate to predict the collection rate in an economy that has recently declined.

Cash Balances

The reporting of cash and cash equivalent balances should take into account any issues related to the liquidity of the balances. With the decline in the economy we have seen previously liquid assets, such as auction rate securities, become illiquid due to changes in the market for those securities. We have also seen some investment companies place new restrictions on the ability to draw funds out of certain investments due to liquidity issues of the underlying assets. If you have any cash or cash equivalent balances that have a change in liquidity you should consider the impact on the valuation of the asset as well as the need to potentially report it as a noncurrent asset.

Year-end disclosures regarding cash and cash equivalent balances should be reviewed carefully this year. Consider the need to disclose restrictions on your ability to access and use cash and cash equivalent balances. If there are any concentrations of cash and cash equivalent balances with one bank or investment company, that concentration should be disclosed. Additionally, any balances held with one institution in excess of FDIC or SIPC insurance should also be disclosed.

Debt

Any loan you have that is maturing in the coming year, especially a loan with a large balloon payment at maturity, should generally be reported as a current liability. The loan can be reported noncurrent only if you obtain commitment from the bank that they will refinance or extend the loan beyond the coming year. Generally accepted accounting principles (GAAP) have very specific requirements of the elements the “commitment” must contain. Lenders have become less willing to refinance or renew existing loans, so it is important to start working with your lender as soon as possible to work out the details of any refinance or extension.

Special consideration should be given to tax-exempt bonds. These bonds typically require a letter of credit from a third party as a credit enhancement. Without the existence of an acceptable letter of credit the bond documents often call for the bonds to become immediately due and payable. The reporting of the bond debt as current or noncurrent should take into consideration the status of the related letter of credit. Issues that might cause the bond debt to be reported as a current liability can include the pending expiration of the letter of credit or a downgrade in the credit rating of the institution that has issued the letter of credit.

Endowment Funds

With the significant decline in the value of investments many organizations are finding their donor-restricted endowment funds to be “underwater.” Underwater endowment funds are those that have total asset values that have declined below the historic dollar value of the original donor gifts. GAAP requires footnote disclosure regarding the deficits in underwater endowments.

Significant Risks and Uncertainties

GAAP requires that your footnote disclosures provide information necessary for users not familiar with your operations to identify and consider the broad risks and uncertainties associated with your operations. Generally, the areas in which you should consider providing disclosures include the nature of your operations, use of estimates in preparing your financials, any significant estimates made in preparing the financials, and vulnerabilities due to concentrations. Specific examples of significant risks and uncertainties you should disclose would include government or other funding that is being reduced or eliminated, reductions in earned revenue sources such as ticket sales, rents, and fees, and the ability to get lines of credit or notes payable renewed or extended.

We would be happy to assist you with any of your questions. Please call us at 941-365-4617 or email Rob Lane at rlane@kgrp.com or Patricia Entsminger at pentsminger@kgrp.com.

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