Nonprofit Colorado

Initial Measurement of Long-term Unconditional Promises to Give

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While many gifts are made immediately, donors may also make a **promise to give** either financial or nonfinancial assets at some point in the future. These promises to give (pledges) may take the form of oral or written communication. When pledges are received, nonprofits should obtain an understanding of the donors' intent in order to properly recognize or not recognize the gift as contribution revenue. The remainder of this article assumes that such understanding has been obtained, and will focus on **proper recognition of long-term unconditional promises to give** based on the Financial Accounting Standards Board (FASB) Codification.

An **unconditional promise to give** is a promise made by a donor whose receipt depends only on the passage of time or the donee's demand for performance. Generally Accepted Accounting Principles (GAAP) requires that the revenue be recognized in the same period the promise is received. Additionally, verifiable documented evidence of the promise must exist for it to be recognized as contribution revenue.

GAAP generally requires the initial measurement of a pledge to be the gift's **fair value**. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Several methods may be used to determine fair value, including one that establishes a framework for measuring fair value utilizing marketplace inputs and valuation techniques to develop fair value measures. When present value techniques are used to measure the fair value of an unconditional promise to give cash assets, nonprofits should determine the amount and timing of the future cash flows. In making the determination, the organization must consider such elements as:

- When the gift will be collected;
- The creditworthiness of the donor;
- The organization's prior collection experience and its policies regarding the enforcement of promises to give;
  Inherent uncertainties about the timing of cash flows; and
- Any other factors which may affect the receivables collectability.

Unconditional promises to give that are expected to be **collected in less than one year** may be measured at net realizable value, as that amount results in a reasonable estimate of fair value.

If nonprofits expect the gift's **collection to occur more than one year in the future** and the fair value is measured utilizing present value techniques, the organization should use a **discount rate** that is

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consistent with the general principles for present value measurement. The discount rate should be determined at the time the unconditional promise to give is initially recognized and should not be revised unless the organization elects to measure the promise to give at fair value in conformity with specific FASB guidelines.

When determining fair value, nonprofits need to **consider the quantity and nature of promised noncash assets** that are expected to be received as a gift. Several techniques may be utilized in making this determination. If present value techniques are used, the fair value might be determined based on the present value of the projected fair value of the underlying noncash assets at the date and expected quantity those assets are expected to be received, if the date is one year or more after the financial statement date. Nonprofits should consider the likelihood of the promise being fulfilled and the future fair value of those underlying assets, such as the future fair value per share of a promised equity security, when determining the future amount to be discounted. If the future fair value is difficult to determine, the fair value may be based on the fair value of the underlying asset at the date of initial recognition and no discount for the time value of money shall be reported in measuring the fair value of the contribution.

An important note to remember is that in **reporting unconditional promises to give on the statement of financial position (receivable) and the related contribution revenue in the statement of activities**, nonprofits should recognize any initial reduction of the gross receivable amount for all unconditional promises to give a **reduction of the revenue and receivable balances**, not a bad debt expense and allowance for uncollectible promises.

When determining an appropriate discount rate, the following general principles should be considered.

- Discount rates should reflect assumptions that marketplace participants would use in their estimates.
- Discount rates should consider only factors related to the asset the organization is measuring.
- Assumptions about discount rates should be internally consistent.
- Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.
- A risk-adjusted discount rate is derived from observed returns for a comparable asset that is traded in the marketplace.

Once the organization has determined the appropriate discount rate, **present value computations may be performed to calculate the amount of revenue and unamortized discount to be recognized**. A number of different tools, including spreadsheet programs that include present value functions when given specified input assumptions, are available to aid in this calculation. If the promise includes multiple equal payments in each of several future years, a present value factor for an ordinary annuity may be utilized to measure the present value of the gift revenue and amount of unamortized discount.

Finally, for most cases, disclosures about the fair value of unconditional promises to give are not required. However, there are two exceptions:

- If a nonprofit has total assets of $100 million or more, has issued debt or conduit debt that trades in a public market, or has derivative instruments, it must make the fair value disclosures required by specific FASB guidelines
- If a nonprofit has made fair value election in conformity with the Fair Value Option Subsections of specific FASB guidelines, it must disclose several items about unconditional promises to give as required by the guidelines as of each date for which a statement of financial position is presented.

Because contributions are an important source of revenue for nonprofit organizations and the guidance regarding fair value continues to develop, the accounting treatment for their recognition is important for nonprofit leaders to understand. Changing economic conditions make this more important – and more challenging – to execute than in the past.

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*Eide Bailly is a top 25 national CPA and business advisory firm with six offices in Colorado (Golden, DTC, Boulder, Frisco/Vail, Grand Junction) and 19 offices nationally. Eide Bailly serves more than 900 nonprofits, and provides a full array of services including audit, tax and accounting. Contact **Susann** or **Julie** at (303) 770-5700 or shartwig@eidebailly.com; jreitz@eidebailly.com. **www.eidebailly.com***