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Recent Developments in Accounting Concepts and Standards for Churches and Church-Related Organizations

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RECENT DEVELOPMENTS IN ACCOUNTING CONCEPTS AND STANDARDS FOR CHURCHES AND CHURCH-RELATED ORGANIZATIONS

THEOBALD DURING

When, in April 1971, the National Conference of Catholic Bishops (NCCB) published an accounting manual, entitled *Diocesan Accounting and Financial Reporting*,[1] it was the first time that the American Catholic Church had sponsored and issued a comprehensive guide for accounting and reporting economic resources under the control of dioceses and archdioceses. Obviously, these entities accounted for and reported economic resources entrusted to them long before the publication date of this manual. Those endeavors, however, can best be described as forms of selective reporting, usually cash receipts and disbursements, with occasional embellishments, as, for example, cash on hand at the beginning and end of a reporting period, investment holdings, and the results of fund drives. Seldom, if ever, did the earlier reports include a balance sheet, an operating statement, a statement of changes in fund balances, and notes disclosing significant accounting policies and other relevant data not readily quantifiable for inclusion in the financial statements themselves.

The 1971 NCCB manual sought to make substantial improvements

[1] NATIONAL CONFERENCE OF CATHOLIC BISHOPS, DIOCESAN ACCOUNTING AND FINANCIAL REPORTING (1971).

in diocesan accounting and reporting practices. Its stated primary objective was

> to present a system of accounting and financial reporting which will be usable by each and every diocese in the United States . . . [and] permit financial reporting to the Ordinary, the Catholic community or the community at large.[2]

Because of the varied practices which prevailed prior to the publication of the manual, the stated secondary objective was

> to serve as an educational device for the Ordinary, the fiscal officers and the accounting profession.[3]

The text of the manual contains accounting standards for dioceses, statements of fiscal policies, an illustrated chart of accounts, and financial statement formats, together with detailed accounting instructions.

It is generally believed that the manual reached its objectives admirably. It "presents a system of accounting and financial reporting which will be usable by [the Ordinary] and it can serve as an educational device for the Ordinary . . . ."[4] As it turned out, however, the dioceses made little use of the manual as it was intended, in spite of the original NCCB sponsorship. This was the case notwithstanding that regional workshops were conducted to acquaint diocesan fiscal personnel with the workings of the manual.

Despite the limited use made of the manual, by 1975 some diocesan fiscal managers voiced the opinion that certain parts of the manual required revision. The revisions, it was claimed, would make the manual acceptable to more dioceses. It is questionable whether these opinions were based on actual experience. Perhaps they were the manifestations of a certain resentment, nurtured by the belief that the NCCB manual was the product of a fairly influential group in the American Catholic Church.

In 1976, the Diocesan Fiscal Management Conference (DFMC) voted to undertake such a revision and, toward that end, selected a committee, the USCC Accounting Practices Committee, to carry out the conference vote. The committee, however, had barely begun its work when a subcommittee of the American Institute of Certified Public Accountants (AICPA) Committee on Nonprofit Organizations was ready to release a draft of an audit guide intended to cover all nonprofit organizations not then covered by existing audit guides. The organizations for which audit guides existed were colleges, universities, hospitals, health and welfare organizations, and state and local government. All other nonprofit organiza-

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[2] *Id.*

[3] *Id.*

[4] *Id.*

tions, including churches and church-related organizations, were to be covered by the emerging audit guide. When the exposure draft became available, the DFMC, after regional meetings, prepared the response of the Catholic Church. The Catholic Church was joined in its efforts by representatives of the Protestant and Jewish faiths, and, with them, attended a public hearing before the AICPA subcommittee.

As one might surmise, the objections to many of the provisions of the draft of the AICPA subcommittee were numerous and vehement. The final product incorporated a limited number of changes. The completed audit guide, a modified version of the subcommittee draft, was published in 1978.[5] While the publication does not have an effective date, and, therefore, does not require implementation, the Financial Accounting Standards Board (FASB), the top rule-making body of the accounting profession, has designated it as preferred accounting literature. It has thereby mandated the adoption of its provisions by any nonbusiness organization. The only change that such an organization may make is to a standard set forth in Statement of Position (SOP) 78-10.[6] All of this applies only to external reporting.

After SOP 78-10 had become a reality, the Catholic dioceses in the United States were still faced with somewhat of a dilemma. They had expressed dissatisfaction with the 1971 NCCB manual and wanted revisions, and were unhappy with SOP 78-10. At the same time, the FASB added an accounting concepts and standards project to its agenda. The significance of this development is that it foreshadowed a review and possible revision and consolidation of existing AICPA audit guides for all nongovernment business organizations. Review and revision of these audit guides were necessitated by inconsistencies among them, some of which were substantial.

In this climate, the USCC Accounting Practices Committee concluded that its best approach to accomplish the pending revision of the NCCB manual and to restate its objections to some of the provisions of SOP 78-10 would be to use SOP 78-10 as a format, adopting those provisions which were noncontroversial, omitting those which did not apply to churches and church-related entities, and modifying those provisions which, in the opinion of the Committee, required some minor modifications to be acceptable. The document which emerged from this process is the document which was presented to and adopted by the NCCB at its November meeting in Washington, D.C. Appendices to the text are cur-

[5] American Institute of Certified Public Accountants, *Statement of Position No. 78-10: Accounting Principles and Reporting Practices for Certain Nonprofit Organizations* (1978), *reprinted in* AM. INST. CERTIFIED PUB. ACCOUNTANTS, STATEMENTS OF POSITION OF THE ACCOUNTING STANDARDS DIVISION 437 (1981).

[6] *Id.*; *see* M. MILLER, PREFERABLE ACCOUNTING PRINCIPLES 439-48 (1980).

rently in the process of being completed and should be available shortly.

Some of the more significant changes embodied in the recently adopted document will now be discussed. The 1971 manual presented financial statements exclusively on a fund accounting basis. The new document permits the use of the equity or commercial type financial statements, as does SOP 78-10. In addition, the 1971 manual displayed a funds section called "endowment and similar funds." It included not only pure endowment funds but also funds set aside by administrative decision to function as an endowment. These internally restricted funds could be transferred to current funds whenever the diocesan administration saw fit to do so. The new document would limit the endowment funds to pure endowments, whereas the former quasi-endowments will be displayed as current undesignated, current designated or current restricted funds, depending upon the facts in each case.

With respect to restricted contributions received during the fiscal year, if current funds were expended for the same purpose that subsequently restricted contributions were received, the 1971 NCCB manual did not require that the restricted contributions be included in operating income to the extent that the donor restrictions were satisfied. They could simply be added to the restricted funds balance. The new document does not allow for this approach. Instead, it seeks to remove donor restrictions at the earliest possible time and conserve unrestricted income as much as possible.

As can be seen from these examples, the changes are hardly radical. In the opinion of the professional advisors who served on the USCC Accounting Practices Committee, there should be no impediment to moving from the 1971 NCCB manual to the modified SOP 78-10 adopted by the NCCB. It should be understood, however, that this new guide for churches and church-related entities will not receive FASB approval. It will merely serve as a resource document for FASB in its ongoing process of developing appropriate accounting concepts and standards for the entire nongovernment-nonbusiness sector. It seems that what dioceses and other church-related entities should do is prepare for the more sweeping changes FASB will propose in the not too distant future.

For the benefit of those who may not be fully aware of what the FASB is and what its functions are in the area of financial accounting and external reporting, FASB as the top rule-making body of the accounting profession, is one tier of a three-tiered organization; the other two tiers are the Financial Accounting Foundation and the Financial Accounting Standards Advisory Council. This three-tiered body was created in the 1970's, after the accounting profession came under substantial criticism from a congressional committee chaired by Senator Morse. The work of the Morse Committee resulted in a congressional report, entitled *The Ac-*

counting Establishment.[7]

Although congressional criticism focused largely upon happenings traceable to financial reporting in the business sector, the nonbusiness sector did its share to attract unfavorable attention. The Catholic Church was no exception: religious communities here and there were known to be in financial difficulties and were saved from default only because of fraternal assistance. Partly because of these happenings and partly because of a desire for a balanced approach to the development of accounting concepts and standards, the FASB commissioned Professor Robert N. Anthony of the Harvard Graduate School of Business Administration in 1977 to prepare a research report which was published in 1978.[8] The research report formed the basis of an invitation to nonbusiness organizations to comment on a series of conceptual issues.[9]

At this point in time, nothing has been heard from FASB concerning nonbusiness organizations. FASB, however, has remained active. With respect to the business sector, FASB has remained so active that one professional publication recently published an article on accounting standards.[10] The headnote to the article states:

> In the view of many practitioners serving smaller nonpublic clients, application of the extensive and complex network of accounting standards in its entirety is no longer cost effective. How to deal with this is not a simple matter. The author, with his long experience in professional standards, summarizes the efforts being made toward a course of action he believes will be of significant help.[11]

Concerning the nonbusiness area, FASB, in its 1981 report, makes reference to *Statement of Financial Accounting Concepts No. 4* and continues by stating that "also part of the conceptual framework is a project on reporting the performance of nonbusiness organizations. Work is focusing initially on the applicability of earlier concept statements to accounting for contributions. An exposure draft is expected to be published in 1982 and a Statement of Concepts in 1983."[12]

In addition to accounting for contributions and grants, FASB is very much concerned with accounting for depreciation, defining the reporting entity, displaying financial position and results of operations, and ac-

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[7] S. Doc. No. 34, 95th Cong., 1st Sess. 1 (1977).

[8] R. ANTHONY, FINANCIAL ACCOUNTING IN NONBUSINESS ORGANIZATION, AN EXPLORATORY STUDY OF CONCEPTUAL ISSUES (1978).

[9] The invitation and resultant comments culminated in a report entitled *Statement of Financial Accounting Concepts No. 4, Objectives of Financial Reporting by Nonbusiness Organizations*, December 1980.

[10] Kelley, *Accounting Standards Overload—Time for Action?*, 52 CPA J., May, 1982, at 10.

[11] *Id.*

[12] *Id.*

counting for investments. It refers to these five issues as pervasive standard issues. These are the issues the fiscal managers of dioceses and their advisors should start considering right now. Since FASB is focusing on them, the small amount of lead time should be used to the greatest advantage.

One would have to assume that attorneys, like accountants, view real and personal property in exactly the manner in which their training has prepared them, namely, as a collection of identifiable rights that enables the holder of the rights to do a number of things and derive certain benefits. Because our attention has been riveted on this concept, it is possible that we have failed to consider certain alternatives. The capitalization and depreciation of so-called plant assets, that is, land, building and equipment, have generated innumerable debates that produced far more heat than light, and to date have failed to move either the opponents or the proponents off dead center. Buildings and equipment are thought of as conventional property. Since dioceses and other church-related entities are essentially services oriented, however, it should be possible to postulate that their acquisition of real and personal property represents an administrative decision to own rather than rent the required facilities for a variety of reasons and that the purchase price represents essentially prepaid rent. As such, it should be allocated ratably to operations of each fiscal year benefiting from the rent prepayment. To accept this premise is to succeed in removing the red cloth, represented by the word depreciation, from the arena. A lot of work will have to be done even if this concept is acceptable. It does appear, however, to be the first time that there is a possibility of movement concerning this issue.

Another pervasive standards issue, according to the FASB, involves accounting for contributions, both unrestricted and restricted. Contributions to church organizations represent financial support from the general public, predominantly the faithful. Such support is provided without expectation of a direct benefit but implies approval of the services emanating from the recipient organization.[13] A closer examination of contributions produces sharper delineation of the other components of financial resource inflow into church organizations, namely, revenues and proceeds

[13] R. ANTHONY, *supra* note 8, at 192. The author of this research report selected the following quote from material I submitted as a member of the group of "Advisors to the Research Study":

> Religious and charitable organizations function, in part, as temporary stores of economic resources committed to improving the quality of life, both materially and spiritually. The original owners of these resources, in relinquishing their property rights by gift, are deemed to have designated the respective donee organizations as their agents to accomplish the goals for which individual efforts would be too feeble to be effective.

Id. at 167. The statement describes the support functions of contributions.

from fund raising. Income from investments is a derived, not a primary financial resource inflow item. Revenues are the fees for services and the proceeds from the sale of goods, no matter how disproportionate they may be in relation to the cost of providing them. For example, the tuition for a pupil in parochial school may be $400 per year, with the per capita cost possibly twice that amount. Nevertheless, the tuition amount represents revenue. Fund raising is a device used by nonbusiness organizations to obtain funds for both current operations and capital additions. It takes many forms, such as dinners, entertainment, games, tours, and flea markets.

Financial resources flowing into church organizations do not exhibit any characteristics that would enable one to differentiate them from similar resources coming into the possession of other nonbusiness entities. As a consequence, the claim by some diocesan fiscal managers that the uniqueness of churches should extend to accounting for the temporal goods of church organizations appears to be contrived, and thus untenable. This is the position that is likely to surface in the FASB exposure draft to be circulated later this year.