

Differences between Nonprofit and For Profit Financial Statements: An Overview

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This note provides an overview of the differences in format and structure between the basic financial statements in the for-profit and not-for-profit sectors. It also highlights several of the major accounting principles and standards of not-for-profit accounting necessitated by restrictions associated with the funding sources of not-for-profits.¹ A basic knowledge of for-profit accrual accounting is assumed.

The Basic Statements

The table below enumerates the basic required statements of entities in each of these two sectors.

| | For-Profit | Not-For-Profit |
|--|-------------------|-----------------------|
| Balance Sheet (Statement of Financial Position) | X | X |
| Income Statement | X | |
| Statement of Changes in Shareholders' Equity | X | |
| Cash Flow Statement | X | X |
| Statement of Activities | | X |
| Statement of Functional Expenses | | X |

We will use the financial statements of The Oregon Humane Society (OHS) to inform our discussion. OHS is a stand-alone, private animal welfare organization founded in Portland, Oregon, in 1868. It has a variety of sheltering, medical, education and rescue programs and is funded entirely by private donations and earned service revenue.²

The Balance Sheet

Both of the sectors require balance sheets. While there are many similarities between the balance sheets of for-profits and not-for-profits there are also several major differences. The major difference is that there is no equity section in the not-for-profit statement as there are no shareholders in a not-for-profit. Instead, the for-profit shareholders' equity section is replaced by a section entitled "net assets". The net asset section shows the sources of its funding and any restrictions associated with that funding. There are two basic categories of funding: funding that comes without any donor restrictions and funding that comes with donor restrictions. Donor

¹ Chapter 1, Introduction to Financial Accounting for Not-For-Profit Entities, R. Antle and S.J. Garstka provides some general background on the differences between governance and funding of not-for-profit entities and for-profit entities. These governance and funding differences necessitate different GAAP.

² The OHS audited financial statements along with its annual report can be accessed at <https://www.oregonhumane.org/resources-publications/publications/>

restrictions can be either temporary in nature (this funding must be used for a specific purpose or in a particular time period) or permanent (the contribution must be held in perpetuity and only future earnings on the gift may be spent). Refer to the statement of financial position for OHS shown below. The OHS net asset balances shows net assets both unrestricted and restricted.

OREGON HUMANE SOCIETY
STATEMENT OF FINANCIAL POSITION
 DECEMBER 31, 2018
 (WITH COMPARATIVE AMOUNTS FOR 2017)

| | 2018 | 2017 |
|--|----------------------|-------------------|
| Assets: | | |
| Cash and cash equivalents | \$ 2,412,589 | 3,776,623 |
| Grants, contributions, and bequests receivable (note 5) | 10,326,690 | 10,457,059 |
| Prepaid expenses, inventories, and other assets | 316,420 | 270,594 |
| Investments (note 6) | 40,591,834 | 33,879,877 |
| Property and equipment (note 7) | 18,421,521 | 15,737,590 |
| Beneficial interest in charitable trusts held by others (note 8) | 1,910,871 | 723,198 |
| Total assets | \$ 73,979,925 | 64,844,941 |
| Liabilities: | | |
| Accounts payable and accrued expenses | 535,055 | 416,202 |
| Construction payable | - | 81,399 |
| Accrued payroll and related expenses | 1,023,236 | 776,283 |
| Liabilities under split-interest agreements (note 9) | 248,231 | 181,926 |
| Deferred compensation (note 10) | 1,021,597 | 992,513 |
| Total liabilities | 2,828,119 | 2,448,323 |
| Net assets: | | |
| Without donor restrictions: | | |
| Available for general operations and programs | 12,167,602 | 16,685,327 |
| Designated by Board for endowment (note 11) | 10,330,888 | 9,971,328 |
| Net investment in capital assets | 18,421,521 | 15,737,590 |
| Total without donor restrictions | 40,920,011 | 42,394,245 |
| With donor restrictions (note 12) | 30,231,795 | 20,002,373 |
| Total net assets | 71,151,806 | 62,396,618 |
| Commitments and contingencies (notes 5, 9, 10, and 17) | | |
| Total liabilities and net assets | \$ 73,979,925 | 64,844,941 |

See accompanying notes to financial statements.

Somewhere in the financial statements the reader must be given information as to the nature of the restrictions on net assets. There are various options of doing this. Sometimes it is on the face of the balance sheet and more often, more detailed information is given in the footnotes. This is the basic challenge of nonprofit statements—to convey to users the nature of restrictions

on the net assets and to enable the reader to assess whether or not the nonprofit has met its fiduciary responsibilities with respect to these restrictions.

If the Board of the nonprofit has earmarked some unrestricted assets for specific purposes, it must be disclosed. But notice, even if assets have been designated by the Board they as still listed as unrestricted as ONLY DONORS can place binding restrictions on assets. The Board could change its mind and redesignate the assets for some other use.

Without going into great detail another basic issue for readers of nonprofit statements is to assess liquidity. For instance, some cash, or for that matter all of it, may have donor restrictions on it as to purpose. Maybe it can only be spent on specific programs. Furthermore, not all of the cash in OHS is necessarily listed in the cash account—some of it might be included in the investment/endowment accounts. We will come back to this liquidity assessment issue later on.

Even in the basic statement of financial position there are several presentation options in nonprofit statements. See the example below for the Portland Art Museum. For each category

PORTLAND ART MUSEUM

STATEMENTS OF FINANCIAL POSITION

JUNE 30, 2018 AND 2017

| | 2018 | | Total |
|--|----------------------------|-------------------------|-------------|
| | Without donor restrictions | With donor restrictions | |
| Assets: | | | |
| Cash and cash equivalents <i>(note 6)</i> | \$ 1,548,113 | 186,848 | 1,734,961 |
| Short-term investments <i>(note 6)</i> | — | 3,538,985 | 3,538,985 |
| Accounts receivable | 177,190 | — | 177,190 |
| Contributions receivable <i>(note 4)</i> | 362,420 | 15,336,769 | 15,699,189 |
| Inventories and prepayments <i>(note 5)</i> | 836,852 | — | 836,852 |
| Other assets | — | 424,108 | 424,108 |
| Investments <i>(notes 6)</i> | 8,417,443 | 56,292,673 | 64,710,116 |
| Beneficial interest in charitable trusts <i>(note 7)</i> | — | 1,136,614 | 1,136,614 |
| Real estate investments, at cost <i>(note 18)</i> | 4,837,854 | — | 4,837,854 |
| Property and equipment <i>(note 8)</i> | 50,163,328 | — | 50,163,328 |
| Museum collections <i>(note 9)</i> | | | |
| Total assets | \$ 66,343,200 | 76,915,997 | 143,259,197 |
| Liabilities: | | | |
| Accounts payable and accrued expenses | 665,735 | 118,828 | 784,563 |
| Accrued payroll and related expenses | 838,952 | — | 838,952 |
| Deferred revenues <i>(note 10)</i> | 596,596 | — | 596,596 |
| Other liabilities | — | 183,986 | 183,986 |
| Due to (from) other funds | (2,552,786) | 2,552,786 | — |
| Total liabilities | (451,503) | 2,855,600 | 2,404,097 |
| Net assets: | | | |
| Without donor restrictions: | | | |
| Available for programs and general operations | 3,357,294 | — | 3,357,294 |
| Designated by the Board of Trustees <i>(note 11)</i> | 8,436,227 | — | 8,436,227 |
| Net investment in capital assets and real estate investments | 55,001,182 | — | 55,001,182 |
| Total net assets without donor restrictions | 66,794,703 | — | 66,794,703 |
| With donor restrictions <i>(note 12)</i> | — | 74,060,397 | 74,060,397 |
| Total net assets | 66,794,703 | 74,060,397 | 140,855,100 |
| Commitments and contingencies <i>(notes 6, 17, 18, 19, and 20)</i> | | | |
| Total liabilities and net assets | \$ 66,343,200 | 76,915,997 | 143,259,197 |

See accompanying notes to financial statements.

of asset and liability the amount of that asset or liability are broken up between unrestricted and restricted. But do not confuse unrestricted with liquidity. While the museum has a large amount of unrestricted assets most of them are tied up in property and equipment, a very illiquid asset!

One other interesting item for museums, universities, or nonprofits in general that have art collections. Notice in the Portland Art Museum balance sheet above there is not an asset entitled "Collections". Most museums and nonprofits with art collections have chosen not to include the value of their collections in their statements of financial condition under an FASB rule which, if they agree to adhere to, permits nondisclosure. The Portland Museum last disclosed their collection value in the financial statements about 15 years ago at which time the collection had an estimated value of over \$60 million dollars.

[The Statement of Activities and Statement of Functional Expenses](#)

The not-for-profit activities is an amalgam of the for-profit income statement and the statement of changes in shareholders' equity. There is no one acceptable format but the most common one is the columnar one like that of OHS displayed on the next page. There is no iron clad definition of operations so the labeling and order of the items varies. The activities statement explains the change in net assets during the reporting period. In that sense it is more like the statement of changes in shareholders' equity in for profit accounting. Oftentimes, the column entitled "without donor restrictions" under operating activities is viewed as the "income statement". There always is a line in this statement called "net assets released from restrictions for operating purposes". This shows the amount of net assets that were restricted as to purpose or time whose time expired or there was a purpose for which the asset was used this period.

It is worthwhile to point out that, for heavily endowed institutions, only the amount of the endowment that is able to be used in the current period (usually determined by a systematic spending rule) would be included in operations. The difference between what was spent from the endowment and the actual returns from the endowment are included in non-operating activities.

Usually the expense categories are given by program and then management and general, and fundraising. A separate schedule of expenses by functional category must also be presented for all nonprofits. The OHS statement of functional expenses can be viewed below.

[The Statement of Cash Flows](#)

One of the most useful statements is the statement of cash flows. This statement in both sectors is divided into three sections which describe cash flows from operations, financing and investing. In both sectors there are two formats which can be used, the direct method and the indirect method.

In the for profit sector either the direct method or the indirect method may be used as the primary cash flow statement in the annual report. If the direct method is used then the indirect method statement, a reconciliation of net income to cash flow from operations, must be presented as a footnote in the statements. If the indirect method is used then the direct method need not be reported.

OREGON HUMANE SOCIETY

STATEMENT OF ACTIVITIES

YEAR ENDED DECEMBER 31, 2018
(WITH COMPARATIVE TOTALS FOR 2017)

| | 2018 | | Total | 2017 |
|--|----------------------------|-------------------------|-------------------|-------------------|
| | Without donor restrictions | With donor restrictions | | |
| Operating revenues, gains, and other support: | | | | |
| Grants and contributions | \$ 6,698,895 | 1,433,797 | 8,132,692 | 6,794,987 |
| Legacies and bequests | 3,707,924 | 1,815,282 | 5,523,206 | 5,563,058 |
| Special events, less direct costs of \$874,020 in 2018 and \$987,903 in 2017 | 1,315,651 | — | 1,315,651 | 1,397,746 |
| Sales and program fees, less cost of sales of \$298,960 in 2018 and \$337,823 in 2017 | 3,485,612 | — | 3,485,612 | 3,230,872 |
| Rental income | 271,420 | — | 271,420 | 260,839 |
| Operating investment return (note 6) | (642,572) | (69,049) | (711,621) | 2,221,962 |
| Change in the actuarial value of liabilities under split-interest agreements | — | (19,986) | (19,986) | (15) |
| Change in the value of the Society's beneficial interest in charitable trusts | — | 12,367 | 12,367 | (1,910) |
| Other | 10,246 | — | 10,246 | 21,934 |
| Total operating revenues and gains | 14,847,176 | 3,172,411 | 18,019,587 | 19,489,473 |
| Appropriation of endowment and Board-designated assets for expenditure (notes 6 and 13) | 448,955 | 180,845 | 629,800 | 157,581 |
| Net assets released from restrictions for operating purposes (note 14) | 1,957,135 | (1,957,135) | — | — |
| Total operating revenues, gains, and other support | 17,253,266 | 1,396,121 | 18,649,387 | 19,647,054 |
| Expenses (note 15): | | | | |
| Program services: | | | | |
| Sheltering and adoptions | 5,650,604 | — | 5,650,604 | 5,308,586 |
| Medical services | 2,451,482 | — | 2,451,482 | 2,197,778 |
| Community awareness | 2,660,726 | — | 2,660,726 | 1,649,952 |
| Humane education | 318,313 | — | 318,313 | 282,382 |
| Investigations and rescue | 793,730 | — | 793,730 | 828,444 |
| Best Friends' Corner | 288,579 | — | 288,579 | 281,551 |
| Volunteers | 350,163 | — | 350,163 | 333,922 |
| Behavior, training, and animal-assisted interactions | 700,303 | — | 700,303 | 652,152 |
| ASAP/Spay & Save | 299,566 | — | 299,566 | 376,097 |
| Total program services | 13,513,466 | — | 13,513,466 | 11,910,864 |
| Supporting services: | | | | |
| Management and general | 1,861,188 | — | 1,861,188 | 1,142,824 |
| Fundraising | 2,275,511 | — | 2,275,511 | 1,999,714 |
| Total supporting services | 4,136,699 | — | 4,136,699 | 3,142,538 |
| Total expenses | 17,650,165 | — | 17,650,165 | 15,053,402 |
| Increase (decrease) in net assets before non-operating activities | (396,899) | 1,396,121 | 999,222 | 4,593,652 |
| Non-operating activities: | | | | |
| Contributions restricted for capital purposes | — | 9,238,132 | 9,238,132 | 11,928,546 |
| Total endowment and Board-designated investment return, less appropriations for expenditure (notes 6 and 13) | (1,077,335) | (404,831) | (1,482,166) | 1,766,690 |
| Increase (decrease) in net assets | (1,474,234) | 10,229,422 | 8,755,188 | 18,288,888 |
| Net assets at beginning of year (note 4) | 42,394,245 | 20,002,373 | 62,396,618 | 44,107,730 |
| Net assets at end of year | \$ 40,920,011 | 30,231,795 | 71,151,806 | 62,396,618 |

See accompanying notes to financial statements.

OREGON HUMANE SOCIETY

STATEMENT OF FUNCTIONAL EXPENSES

YEAR ENDED DECEMBER 31, 2018
(WITH COMPARATIVE TOTALS FOR 2017)

| | 2018 | | | | | | | | | | | | | Total 2016 | Total 2017 | |
|---|--------------------------------|---------------------|------------------------|---------------------|--------------------------------------|----------------------------|------------|--|-------------------------|------------|------------------------------|---------------------------------------|------------------|---------------|---------------|------------|
| | Program services | | | | | | | | Supporting services | | | | | | | |
| | Sheltering and adoptions | Medical services | Community awareness | Humane education | Investi- gations and rescue | Best Friends' Corner | Volunteers | Behavior, training, and animal- related interactions | ASAP/ Snoy & Save | Total | Management and general | Technology and facilities costs | Fund- raising | Total | | |
| Salaries | \$ 2,688,055 | 1,340,630 | 628,476 | 162,126 | 439,866 | 148,346 | 183,062 | 367,051 | 140,183 | 5,997,815 | 849,843 | 769,887 | 1,194,721 | 2,814,451 | 8,812,266 | 7,822,563 |
| Payroll taxes | 201,066 | 90,205 | 44,316 | 13,929 | 31,316 | 13,987 | 13,783 | 26,203 | 12,010 | 446,815 | 52,389 | 57,017 | 84,033 | 193,439 | 640,254 | 581,656 |
| Group insurance | 321,084 | 106,072 | 73,260 | 12,662 | 39,040 | 18,359 | 17,645 | 34,116 | 17,755 | 639,993 | 73,400 | 78,326 | 91,690 | 242,416 | 882,409 | 759,378 |
| Retirement | 104,210 | 57,528 | 33,347 | 5,751 | 24,336 | 7,066 | 8,311 | 17,988 | 5,779 | 264,216 | 69,375 | 41,002 | 67,014 | 177,391 | 441,607 | 405,988 |
| Workers' compensation | 18,433 | 5,475 | 2,963 | 549 | 1,872 | 565 | 820 | 1,453 | 542 | 32,672 | 4,964 | 3,253 | 5,022 | 13,239 | 45,911 | 35,142 |
| Professional services | 25,588 | 8,452 | 141,470 | 1,126 | 2,970 | 1,429 | 1,151 | 18,687 | 2,226 | 203,099 | 466,639 | 64,703 | 50,926 | 582,268 | 785,267 | 421,931 |
| Surgical, medications, and lab | 14,943 | 267,075 | - | - | 13,325 | - | - | - | 69,479 | 365,222 | - | - | - | - | 365,222 | 380,717 |
| Animal transportation and boarding | 93,817 | - | - | - | 4,840 | - | - | - | - | 98,657 | - | - | - | - | 98,657 | 88,738 |
| Feed, shelter, and program supplies | 426,468 | 122,589 | 848 | 16,968 | 14,325 | 812 | 63,102 | 4,661 | 659 | 650,432 | 974 | 3,371 | 544 | 4,889 | 655,321 | 572,927 |
| Office supplies and postage | 16,709 | 6,065 | 2,432 | 660 | 6,634 | 801 | 1,074 | 4,729 | 1,763 | 40,867 | 6,531 | 3,363 | 8,608 | 18,502 | 59,269 | 58,249 |
| Printing | 100 | 105 | 385 | 690 | 235 | - | - | 830 | 530 | 2,875 | 135 | 25,413 | 9,181 | 34,729 | 37,604 | 37,235 |
| Communication | 862 | - | 600 | - | 456 | - | - | - | - | 1,918 | 1,200 | 103,453 | - | 104,653 | 106,571 | 103,034 |
| Direct mail | - | - | - | - | - | - | - | - | - | - | - | - | 244,185 | 244,185 | 244,185 | 231,186 |
| Vehicle maintenance | 15,251 | - | 1,381 | 6 | 6,697 | - | - | - | - | 23,535 | 1,139 | 11,103 | 8 | 12,280 | 35,785 | 64,372 |
| Travel and training | 61,958 | 18,258 | 5,629 | 1,237 | 11,789 | 803 | 3,951 | 6,123 | 377 | 109,125 | 27,556 | 7,787 | 17,216 | 52,559 | 161,684 | 185,829 |
| Occupancy and equipment | 7,674 | 4,069 | 495 | - | 1,760 | - | 2,995 | - | 35 | 17,028 | 573 | 348,561 | 1,628 | 350,762 | 367,790 | 396,766 |
| Repairs and maintenance | 178 | 9,090 | 348 | - | 10 | - | - | - | - | 9,626 | - | 417,571 | - | 417,571 | 427,197 | 351,026 |
| Insurance | 11,462 | 2,090 | 2,084 | 1,255 | 24,915 | 834 | 699 | 764 | 1,651 | 45,754 | 72,706 | 45,905 | 1,734 | 120,345 | 166,099 | 155,214 |
| Dues and subscriptions | 3,262 | 6,732 | 750 | 130 | 6,880 | - | 390 | 1,530 | - | 19,674 | 10,224 | 1,743 | 2,969 | 14,936 | 34,610 | 45,230 |
| Computer | 12,129 | 7,932 | 21,828 | - | 1,756 | 477 | 8,392 | - | 793 | 53,307 | 22,079 | 236,663 | 22,714 | 281,456 | 334,763 | 210,507 |
| Development and promotion | - | 70 | 122,335 | - | 1,987 | - | - | - | 588 | 124,980 | 7,637 | - | 228,012 | 235,649 | 360,629 | 242,209 |
| Public awareness | - | - | 1,392,048 | - | - | - | - | - | 5,436 | 1,397,484 | - | - | 652 | 652 | 1,398,136 | 688,003 |
| Bank fees | 38,510 | 4,228 | 58,891 | 2,912 | 267 | 11,304 | 93 | 3,032 | 12 | 121,249 | 530 | 111 | 47,457 | 48,078 | 169,327 | 162,534 |
| Depreciation | 432,145 | 152,321 | 21,425 | 26,971 | 59,745 | 20,301 | 8,466 | 59,054 | 6,366 | 786,794 | 15,919 | - | 33,290 | 49,209 | 836,003 | 796,340 |
| Other | 21,166 | 17,242 | 2,178 | 1,512 | 32,938 | 102 | 3,296 | 1,021 | 946 | 80,401 | 76,958 | 5,879 | 20,161 | 102,998 | 183,399 | 256,628 |
| Total expenses before allocations | 4,515,070 | 3,136,248 | 2,557,689 | 248,484 | 727,859 | 225,186 | 316,230 | 549,242 | 267,530 | 11,533,538 | 1,789,751 | 2,225,111 | 3,131,765 | 6,116,627 | 17,650,165 | 15,053,402 |
| Allocation of technology and facilities costs | 1,135,534 | 325,234 | 103,037 | 69,829 | 65,871 | 63,393 | 33,933 | 151,061 | 32,036 | 1,979,928 | 101,437 | (2,225,111) | 143,746 | (1,979,928) | - | - |
| Total expenses | \$ 5,650,604 | 3,461,482 | 2,660,726 | 318,313 | 793,730 | 288,579 | 350,163 | 700,303 | 299,566 | 13,513,466 | 1,891,188 | - | 3,275,511 | 4,136,699 | 17,650,165 | 15,053,402 |

See accompanying notes to financial statements.

OREGON HUMANE SOCIETY

STATEMENT OF CASH FLOWS

YEAR ENDED DECEMBER 31, 2018
(WITH COMPARATIVE TOTALS FOR 2017)

| | 2018 | 2017 |
|--|---------------|--------------|
| Cash flows from operating activities: | | |
| Cash received from contributors and grantors | \$ 12,446,263 | 12,685,918 |
| Cash received from service recipients and others | 4,083,725 | 3,851,468 |
| Interest and dividend income | 831,061 | 952,809 |
| Cash paid to employees and suppliers | (15,920,506) | (14,003,130) |
| Net cash provided by operating activities | 1,440,543 | 3,487,065 |
| Cash flows from investing activities: | | |
| Capital expenditures | (3,618,820) | (934,267) |
| Purchase of investments | (10,546,800) | (5,106,126) |
| Reinvestment of interest and dividend income | (813,359) | (937,259) |
| Proceeds from the sale of investments | 2,253,154 | 959,505 |
| Net cash used in investing activities | (12,725,825) | (6,018,147) |
| Cash flows from financing activities: | | |
| Proceeds from contributions restricted for long-term investment | 10,050 | 187,165 |
| Proceeds from contributions restricted to capital acquisition | 9,796,643 | 3,059,818 |
| Proceeds from contributions subject to charitable gift annuity agreements | 150,547 | 15,000 |
| Distributions made under charitable trust and gift annuity agreements | (35,992) | (32,486) |
| Net cash provided by financing activities | 9,921,248 | 3,229,497 |
| Net increase (decrease) in cash | (1,364,034) | 698,415 |
| Cash and cash equivalents at beginning of year | 3,776,623 | 3,078,208 |
| Cash and cash equivalents at end of year | \$ 2,412,589 | 3,776,623 |

See accompanying notes to financial statements.

In the case of not-for-profits either the direct or indirect method statement may be used. If the direct method is used then it is not required to present the indirect method in a footnote. OHS's direct method cash flow statement is shown above, and a footnote in which it shows the indirect method statement is shown below.

One major difference in the cash flow statements for the two sectors is the starting point in the indirect method statement. In the for profit sector the starting point is net income which is to be reconciled to cash flow from operations. In the not-for-profit sector the starting point is the change in net assets which must be reconciled to cash from operations. Because of this there are usually more adjustments in the indirect method operating section because there are many financing and investing transactions that impact net assets and which would not impact net income in a for profit.

20. Statement of Cash Flow Reconciliation

The following presents a reconciliation of the increase in net assets (as reported on the statement of activities) to net cash provided by operating activities (as reported on the statement of cash flows):

| | |
|--|--------------|
| Increase in net assets | \$ 8,755,188 |
| <i>Adjustments to reconcile increase in net assets to net cash provided by operating activities:</i> | |
| Depreciation | 836,003 |
| Net decline in the fair value of investments | 2,395,048 |
| Contribution revenue associated with the issuance of charitable gift annuities | (68,236) |
| Change in the actuarial value of liabilities under split-interest agreements | 19,986 |
| Contribution of the beneficial interest in charitable remainder trusts | (1,175,306) |
| Change in the value of the Society's beneficial interest in charitable trusts | (12,367) |
| Loss on disposal of assets | 17,487 |
| Proceeds from contributions restricted to capital acquisitions | (9,796,643) |
| Proceeds from contributions restricted for long term investment | (10,050) |
| <i>Net changes in:</i> | |
| Grants, contributions, and bequests receivable | 130,369 |
| Prepaid expenses, inventories, and other assets | (45,826) |
| Accounts payable and accrued expenses | 118,853 |
| Accrued payroll and related expenses | 246,953 |
| Deferred compensation | 29,084 |
| Total adjustments | (7,314,645) |
| Net cash provided by operating activities | \$ 1,440,543 |

constraint on the use of the contribution (either time or purpose restriction) or a permanent restriction (the contribution must be held in perpetuity and only the earnings from the gift can be spent).

Grants are a major source of funding for many nonprofits. Grants can have characteristics of exchange transactions or contributions. How the grant is viewed dictates how it will be accounted for. Grants that require nonprofits to provide specific goods or services, or that reimburse a nonprofit for the costs (or cost plus) of providing a particular good or service should be viewed as exchange transactions (both the grantor and the nonprofit are getting benefits from the transaction). For example, a city agency gives a grant to a nonprofit working with homeless people to construct a small apartment complex.

³ FASB Accounting Standards Codification glossary.

Important Not-For-Profit GAAP

Most of the important differences between for-profit and not-for-profit accounting center on accounting for contributions and it is worthwhile to introduce the basic issues.

Contributions and Exchange Transactions

“A contribution is an unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately equal value.” “A promise to give is a written or oral agreement to contribute cash or other assets to another entity.”³ It is unconditional if it only depends on the passage of time or the donee having to ask for it. Contributions or promises that depend on the occurrence of an uncertain specific future event are termed conditional contributions and are not recognized as contribution revenue until the event occurs. Unconditional promises to give are recognized as revenue when the promise is received. Unconditional contributions and unconditional promises to give may come with *donor* restrictions (“strings”). As mentioned above these “strings” may represent a temporary

Grants that are viewed as contributions usually offer support of a more general nature to the nonprofit, this money can be used to support your existing programs or this money can be used at the discretion of the nonprofit. Empirically, most grants from governments to nonprofits are more like exchange transactions and grants from private funders (foundations, individuals, etc.) are often more contribution like.

The punchline!

Contributions increase cash or receivables (or other assets, or decrease liabilities) and simultaneously increase net assets. Exchange transactions, when funding is received in advance of providing the good or service, create liabilities.

Consider the following transaction: Suppose a customer gives a magazine publisher \$100 as a payment for the next ten issues of a magazine. The magazine publisher (because this is an exchange transaction) makes the following journal entry.

| | | |
|-----------------------|-----|-----|
| Cash | 100 | |
| Unearned revenue..... | | 100 |

It recognizes the receipt of cash and creates a liability in the same amount. The \$100 will be taken into revenue as the issues are sent to the customer.

Now suppose the recipient of the \$100 is a not-for-profit and the \$100 is a contribution with conditions but restricted to a particularly use, say scholarships for students in a university. The university will make the following journal entry:

| | | |
|---|-----|-----|
| Cash (temporarily restricted)..... | 100 | |
| Contribution revenue (restricted) | | 100 |

Even though there is an obligation to use the contribution a certain way there is no recording of a liability and the revenue is immediately recognized. The donor in this case is not the beneficiary of the scholarship and therefore it is not an exchange transaction.

Accounting for contributions in this manner can cause difficulties in reading and interpreting the not-for-profit statement. The cash restricted as to purpose is sitting in the cash balance and it is not so easy to signal the restriction to the reader or the fact that it is not available for discretionary spending on the part of the not-for-profit. So standard ratios such as a current ratio (current assets/current liabilities) do not properly assess liquidity.

Other “Problems” Centering on Contribution Accounting

Another issue in reporting has to do with promised contributions which are conditional in nature. For example, a donor pledges \$100,000 to match other donor contributions to a scholarship fund at a university. This is a conditional promise to give and until the time the

university receives contributions from other donors there will not be able to recognize any of the \$100,000 pledge as revenue.

If the above donor actually gave the \$100,000 to the university the university would record the receipt of the cash and would have to create a liability in the same amount as, absent contributions from other donors, the university would have to return the \$100,000.

A municipality could give a forgivable loan to a not-for-profit to construct a building dedicated to low-income housing. The loan would enable the not-for-profit to construct the building. There would be a condition on the loan however, it would be forgiven only when the building is built and turned over to the city. Until that time, the loan would appear on the not-for-profit's balance sheet. So assessing long-term financial health by computing a debt equity ratio would be problematic, as this is not really debt for the not-for-profit, as most likely it will never have to be paid.

19. Liquidity and Availability of Financial Assets

Financial assets available for general expenditure within one year of the statement of financial position date comprise the following at December 31, 2018:

| | |
|---|--------------|
| <i>Total financial assets available to fund general operations:</i> | |
| Cash and cash equivalents | \$ 2,412,589 |
| Grants, contributions, and bequests receivable | 10,326,690 |
| Inventories | 86,959 |
| Investments | 40,591,834 |
| | 53,418,072 |

| | |
|--|--------------|
| <i>Less financial assets not available within the year ending December 31, 2019:</i> | |
| Financial assets restricted by donors for endowment (note 13) | (3,645,792) |
| Financial assets designated by the Board for quasi-endowment (note 11) | (10,330,888) |
| Financial assets restricted by donors for capital campaign (note 12) | (21,766,678) |
| Financial assets restricted by donors for other purposes | (323,862) |
| | (36,067,220) |

| | |
|---|---------------|
| <i>Plus other funds subject to appropriation for expenditure:</i> | |
| Fiscal year 2019 endowment appropriations for operations | 180,800 |
| Board-designated funds approved for expenditure | 445,800 |
| | 626,600 |
| | \$ 17,977,452 |

There are myriad issues in the accounting for contributions in not-for-profits that make it difficult to assess financial health and to understand the not-for-profit's progress and ability in meeting restrictions placed on it by donors. That is why if anyone is serious about working in a not-for-profit they should study a bit of not-for-profit accounting before doing so.

The financial crisis of a decade ago caused many changes in reporting rules in not-for-profit financial statements. Much more needs to be disclosed about classes of assets and their restrictions in footnotes to financial statements. In particular, with respect to liquidity, every not-for-profit must estimate and disclose, as of the balance sheet date, the amount of cash expected to be available for general expenditures during the coming year. See the OHS footnote 19.

As part of its liquidity management, the Oregon Humane Society has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations become due.

In addition, the Society holds quasi-endowment funds totaling \$10,330,888 (see note 11). Although the organization does not intend to spend from its quasi-endowment other than amounts appropriated for general expenditure as part of its annual budget approval and appropriation process, amounts from its quasi-endowment could be made available if necessary.

20. Statement of Cash Flow Reconciliation

The following presents a reconciliation of the increase in net assets (as reported on the statement of activities) to net cash provided by operating activities (as reported on the statement of cash flows):

| | |
|--|--------------|
| Increase in net assets | \$ 8,755,188 |
| <i>Adjustments to reconcile increase in net assets to net cash provided by operating activities:</i> | |
| Depreciation | 836,003 |
| Net decline in the fair value of investments | 2,395,048 |
| Contribution revenue associated with the issuance of charitable gift annuities | (68,236) |
| Change in the actuarial value of liabilities under split-interest agreements | 19,986 |
| Contribution of the beneficial interest in charitable remainder trusts | (1,175,306) |
| Change in the value of the Society's beneficial interest in charitable trusts | (12,367) |
| Loss on disposal of assets | 17,487 |
| Proceeds from contributions restricted to capital acquisitions | (9,796,643) |
| Proceeds from contributions restricted for long term investment | (10,050) |
| <i>Net changes in:</i> | |
| Grants, contributions, and bequests receivable | 130,369 |
| Prepaid expenses, inventories, and other assets | (45,826) |
| Accounts payable and accrued expenses | 118,853 |
| Accrued payroll and related expenses | 246,953 |
| Deferred compensation | 29,084 |
| Total adjustments | (7,314,645) |
| Net cash provided by operating activities | \$ 1,440,543 |