



## THE MUSEUM OF WESTERN ART EXAMPLE

In Chapter 2 we introduced the topic of contributions which are of fundamental importance to most nonprofits. Not surprisingly, because of their importance, the “strings” associated with contributions are featured prominently in the required financial statements and footnote disclosures of nonprofits. To show how all of this plays out in the statements we will go through a detailed example of a hypothetical nonprofit museum, The Museum of Western Art (Western). This will not only help us to understand how the entire accounting cycle (analyze transactions, record transactions, make adjusting entries, close temporary accounts, and prepare statements) plays out in a nonprofit, but will position us to be better able to read and understand published nonprofit financial reports. We will also use the example as a means to flag some of the important managerial tasks that must take place in any nonprofit that receives contributions and grants.

### The Museum of Western Art (Startup)

On December 31, 2018 a wealthy businessman and supporter of the arts established the Museum of Western Art with a \$1,000,000 grant. Assume all of the transactions that follow took place on December 31, 2018. We will record all of the transactions and make up a set of financial statements as of the end of the year, December 31, 2018.

1. The grant was to support general operating expenses and is to be paid in two equal installments of \$500,000, one installment to be paid immediately and the second in two years on January 1, 2021. (The auditor hired in (3) advises that 4% is the appropriate discount rate to use in determining present values.)
2. A staff is hired consisting of a Director and an Assistant Director at annual salaries of \$60,000 and \$36,000 respectively. Associated benefits amount to 30% of the base salaries.
3. The director immediately hired a CPA who currently audits several other regional museums to assist in setting up financial records, making up financial statements and providing general management advice. The fee for these services will be \$50,000 for calendar year 2019 and the CPA agrees to devote at least one day per week in assisting the director and assistant director of Western.
4. Friends of the benefactor contribute major pieces of Western American art under the condition that the art will never be sold and will be held in the museum for viewing. The art is currently valued at \$750,000.

5. Another cash contribution in the amount of \$50,000 is received. The contribution is to underwrite costs incurred in acquiring pieces of art loaned from other museums and individuals for exhibition.
6. WA acquires a small building for \$500,000 in the art district of the town where it is located. WA pays \$50,000 in cash and assumes a 30-year mortgage in the amount of \$450,000. The mortgage carries an interest rate of 5%. The principal amount of the mortgage is to be paid in thirty equal annual payments of \$15,000 beginning on December 31, 2019. Interest on the outstanding balance of the mortgage for the year is also due at this time. The building has an expected useful life of 40 years and is being depreciated on a straight-line basis.
7. Two other business acquaintances of the benefactor pledged the following :
  - a. An unrestricted contribution of \$50,000 if the museum has at least 12,000 paying visitors during the fiscal year ending December 31, 2020, its second full year of operations.
  - b. To match any unrestricted cash contributions the museum receives between July 1, 2019 and July 1, 2020.

### Transaction Analysis and Journal Entries (Startup)

1. The initial \$500,000 received in cash is booked as unrestricted contribution revenue as the donor indicated the grant was to support general administrative and operating expenses. We will find it convenient to label all revenues and receivables with any restrictions that accompany the contribution.

Cash (UNR).....	500,000
Contribution Revenue (UNR).....	500,000

The second installment, as we learned in the previous chapter, should be recorded at its present value. Since it is to be received exactly two years from now, the present value is \$462,278.<sup>1</sup>

Contributions Receivable (LT-TR).....	462,278
Contribution Revenue (LT-TR).....	462,278

We will not make an allowance for uncollectibles as we assume that the benefactor is certain to pay us the second installment when it becomes due. The discount of \$37,722 (\$500,000 - \$462,278) will be amortized into contribution revenue over the next two years.

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<sup>1</sup>  $462,278 = (500,000)/(1.04)^2$

2. Hiring staff is an example of an executory contract. No expense is recognized until time passes and the staff has worked for Western.
3. As in (2), the auditor has not yet performed work for Western and therefore no journal entry is made.
4. As we mentioned in Chapter 2 donated art does not have to be shown as an asset on the balance sheet as long as it is held for public exhibition, education or research purposes, is kept unencumbered, cared for and preserved, and is subject to an organizational policy that requires proceeds from the sale of any collection item to be used to acquire other items for the collection. Most major nonprofits with large art collections do not capitalize them. In the current example we assume that Western has chosen to capitalize its collections. The following journal entry is necessary. This contribution is permanently restricted.

Art Collection .....	750,000
Contribution Revenue (PR) ...	750,000

5. The additional cash contribution of \$50,000 comes with “strings”. It can only be spent to cover costs incurred when the staff seeks to borrow works of art from individuals or other museums to create shows in Western’s gallery. It is temporarily restricted as to use.

Cash .....	50,000
Contribution Revenue (TR)....	50,000

6. The acquisition of the building is recorded just as it would be in a for profit organization.

Building.....	500,000
Cash .....	50,000
Mortgage Payable.....	450,000

7. Both of these pledges are conditional promises to give. Western will get the \$50,000 *if* the museum has at least 12,000 paying visitors during its second year of operations and the match of all unrestricted cash contributions to the museum during the second half of the next fiscal year will be received *only if* and when these things happen. No journal entry is made.

## The t-accounts, adjusting and closing entries and financial statements

No adjusting entries are necessary as all of the above transactions occurred on the last day of the fiscal year. It is necessary to close all of the temporary accounts to various net asset categories (See figure 1 for t-accounts). We were careful to label all revenues as unrestricted, temporarily restricted or permanently restricted. The following journal entry closes each revenue category to the appropriate net asset category.

Contribution Revenue (UNR).....	500,000	
Contribution revenue (TR).....	512,278	
Contribution Revenue (PR).....	750,000	
Net Assets (UNR).....		500,000
Net Assets (TR) .....		512,278
Net Assets (PR).....		750,000

Figure 3.1 shows the Western t-accounts after closing entries have been entered. The t-accounts are now ready to record transactions for the coming year of operations.

**Figure 3.1 Western T-accounts**

<b>Cash</b>			<b>Contribution Rec. (LT, TR)</b>	
BB	-		BB	-
1	500,000	50,000	6	1
5	50,000			462,278
EB	500,000		EB	462,278
<b>Building</b>			<b>Art</b>	
BB	-		BB	-
6	500,000		4	750,000
EB	500,000		EB	750,000
<b>Mortgage Payable</b>			<b>Contribution Rev (UNR)</b>	
	-	BB		-
	450,000	6		500,000
	450,000		C	500,000
				BB
				1
<b>Contribution Rev (TR)</b>			<b>Contribution Rev (PR)</b>	
	-	BB		-
	462,278	1		750,000
	50,000	5	C	750,000
C	512,278			BB
				4
<b>Net Assets (UNR)</b>			<b>Net Assets (TR)</b>	
	-	BB		-
	500,000	C		512,278
				BB
				C
<b>Net Assets (PR)</b>				
	-	BB		
	750,000	C		

The Statement of Activities shown in Figure 3.2 at the end of this fiscal year (the first day of operations) is simple since there are only three revenue categories and Western has not yet incurred any expenses. Note that the statement of activities is presented in a form which highlights how the activities of the year effect net assets without donor restrictions and with donor restrictions (temporary and permanent in total). It also explains the change in each of these two asset categories from the beginning to the end of the year. The statement of activities in a nonprofit is less like an income statement in for profit accrual accounting and more like the statement of changes in shareholders' equity. This is an important distinction between for profit and nonprofit accounting. For example, if a company sold common stock for \$100,000 (obtaining permanent capital) this transaction would not appear on its income statement but would appear in its

statement of changes of shareholders' equity and in its cash flow statement. If a nonprofit received a contribution in the amount of \$100,000 to start an endowment to support its operations it *would* appear in its statement of activities. We will later look at various formats for

the nonprofit statement of activities to help distinguish between revenues and expenses that are “operational” or “other”.

**Figure 3.2 Western’s Statement of Activities for the year ending December 31, 2018**

<b>MUSEUM OF WESTERN ART</b>			
Statement of Activities			
Year ending December 31, 2018			
	Without Donor Restrictions	With Donor Restrictions	TOTAL
CONTRIBUTIONS	500,000	1,262,278	1,762,278
TOTAL	500,000	1,262,278	1,762,278
BEGINNING NET ASSETS	0	0	0
ENDING NET ASSETS	500,000	1,262,278	1,762,278

The statement of financial position as of December 31, 2018 is illustrated in figure 3.3. Unlike in the statement of activities where it is easy to see net asset changes labeled by restriction category, it is more difficult to discern what the restrictions are on individual assets and liabilities. We are given only net asset totals by category. For instance, it is not obvious looking at figure 3 that \$50,000 of the cash cannot be spent paying any arbitrary expense because it is restricted to being spent on activities for putting art shows together for the gallery. This will require footnote disclosure. We will worry about this in more detail later when we analyze the liquidity of Western and engage in other forms of statement analysis.

**Figure 3.3 Western’s Statement of Financial Position as of December 31, 2018**

<b>MUSEUM OF WESTERN ART</b>				
Statement of Financial Position				
December 31, 2018				
CASH	500,000		MORTGAGE PAYABLE	450,000
CONTRIBS. REC. (LT)	462,278			
BUILDING	500,000		NET ASSETS:	
ART	750,000		Without donor restrictions	500,000
			With donor restrictions	
				1,262,278
			Total	1,762,278
TOTAL ASSETS	2,212,278		TOTAL LIAB + NET ASSETS	2,212,278

Another format for the statement of financial position is shown in figure 3.4. This format is not required disclosure as part of GAAP. It is sometimes used internally by management and boards of directors to better see the financial status of the nonprofit. Building values are listed as

unrestricted unless there is some restriction as to specific use put on it by a donor. The mortgage payable is listed as unrestricted since it will be paid out of unrestricted cash. If some donor contributed cash for the sole purpose of paying the mortgage, then that portion of the mortgage that could be paid by this restricted cash would be listed as restricted.

**Figure 3.4 Western’s Statement of Financial Position as of December 31, 2018 (alternative format)**

<b>MUSEUM OF WESTERN ART</b>							
Statement of Financial Position							
December 31, 2018							
	Without Donor Restrictions	With Donor Restrictions	Total		Without Donor Restrictions	With Donor Restrictions	Total
CASH	450,000	50,000	950,000	MORTGAGE PAYABLE	450,000		450,000
CONTRIB. REC. (LT)		462,278	462,278				
BUILDING	500,000		500,000				
ART		750,000	750,000	NET ASSETS	500,000	1,262,278	1,762,278
	950,000	1,262,278	2,212,278		950,000	1,262,278	2,212,278

The direct method cash flow statement is relatively easy to construct in this simple example. Just look at the cash t-account in Figure 3.1 to see that there are only three cash flows, two of which are cash contributions (operations) and the third is an investing use of cash (purchase building). The direct method cash flow statement is shown in Figure 3.5.

We will now also construct the indirect method cash flow statement. The authors believe that this is the most important statement in getting at the underlying economic events and transactions that underlie the balance sheet and statement of activities as it is the link between the accrual numbers and the cash flows. We will use the indirect method statement in almost every chapter when we practice reading and analyzing actual financial statements.

There are many different worksheets used to construct the indirect method cash flow statement.<sup>2</sup> The worksheet, found in Figure 3.6, has the beginning and ending balance sheets at the top of the worksheet with the exception of the cash account which is expanded into sections labeled operations, investing and financing. Like most indirect method worksheets we begin by estimating cash flow from operations as the change in net assets for the period.<sup>3</sup>

<sup>2</sup> The work sheet we will use can be found in Antle, R. and Garstka, S., *Financial Accounting*, Thomson/South-Western, 2004.

<sup>3</sup> In the standard accrual accounting for profit context an estimate of cash flow from operations is usually net income. Because the starting point in a nonprofit context is usually change in net assets for the period (more

**Figure 3.5 Western’s Statement of Cash Flows for the year ending December 31, 2018 (Direct Method)**

<b>MUSEUM OF WESTERN ART</b> Statement of Cash Flows (Direct) Year ending December 31, 2018	
Operations:	
Contributions	550,000
Cash flow from operations	550,000
Financing:	
Cash flow from financing	0
Investing:	
Building	(50,000)
Cash flow from investing	(50,000)
Change in cash	500,000
Beginning balance	0
Ending balance	500,000
SUPPLEMENTAL INFORMATION	
Assumed a mortgage to pay for the building	450,000

The following entries were made in the worksheet:

1, 2, and 3. This enters the changes in the three different categories of net assets into the cash flow from operations section of the worksheet as the initial estimate of cash flow from operations. This is just like entering net income in a for profit company.

Cash (operations) .....	750,000
Cash (operations).....	512,278
Cash (operations) .....	500,000
NA--Perm.....	750,000
NA—TR .....	512,278
NA—UNR.....	500,000

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analogous to change in owners’ equity) more adjustments usually have to be made to derive cash flow from operations.





5. We need to recognize that we acquired a building. We took on a mortgage and paid a small amount in cash.

Building.....	500,000	
Mortgage.....		450,000
Cash .....		50,000

6. Finally, we recognize that a big portion of the contribution revenue was not received in cash.

Contribution revenue.....	462,278	
Cash (operations)..		462,278

The indirect statement of cash flows, taken from the worksheet in Figure 3.6, is shown in Figure 3.7.

**Figure 3.7 Western’s Statement of Cash Flows for the year ending December 31, 2018 (Indirect Method)**

<b>MUSEUM OF WESTERN ART</b> Statement of Cash Flows (Indirect) Year ending December 31, 2018	
Change in net assets	1,762,278
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities	
Contribution of art for permanent collection	(750,000)
Changes in operating assets and liabilities	
Contributions receivable	(462,278)
Cash provided by (used in) operations	<b>550,000</b>
Cash flows from investing activities	
Purchase building	(50,000)
Cash provided by (used in) investing activities	<b>(50,000)</b>
Cash flows from financing activities	
Cash provided by (used in) financing activities	<b>0</b>
Change in cash	500,000
Beginning cash balance	0
Ending cash balance	500,000

Prior to the adoption of accrual accounting for private nonprofits, they were required to use fund accounting. Fund accounting was useful because it created separate pots of money for each contribution with restrictions (a self-balancing set of accounts for each contribution to track the use of the contribution for the intended purpose and to keep track of the balance). This is lost in the current external reporting but something akin to it must be done for internal management and fiduciary responsibility of the donated funds. Some kind of spreadsheet/notes, etc. equivalent to what is shown in Figure 3.8 exists in all private nonprofits. This enables the nonprofit to track spending by supported purpose, provide periodic reports to donors and along with the Figure 3.9, to amortize the discount on contributions received after one year, and to keep track of who has promised to give support to the nonprofit at what time and under what conditions in the future.

**Figure 3.8 Internal Accounting Spreadsheet for Contributions**

CONTRIBUTIONS						
			Amount (present value)			
Contribution	Pledge	Donor	UR	TR	PR	NOTES
500,000		Benefactor	500,000			Paid in full
	500,000	Benefactor		462,278		Due 1/1/21 (UNR)
750,000		NAME			750,000	Permanent collection
50,000		NAME		50,000		Paid in full. Costs incurred to acquire new art pieces

**Figure 3.9 Internal Accounting Spreadsheet for Conditional Contributions**

CONDITIONAL CONTRIBUTIONS (not in financial statements yet)					
		Use			
Amount	Donor	UR	TR	PR	CONDITION
50,000	NAME	50,000			If 12,000 paying visitors during 2020 fiscal year
???	NAME	???			Match all unrestricted contributions from 7/1/19 to 7/1/20

## The Museum of Western Art (The First Year)

The following information relates to the first year of operations for the Museum of Western Art. We will analyze the transactions and construct the financial statements for the year.

8. Miscellaneous supplies are purchased for \$10,000 cash. \$3,000 of these supplies are unused as of December 31, 2019. All supplies were used in operations. This basic transaction is recorded as it would be in a for profit entity.

Inventory (Supplies) .....	3,000	
Supplies Expense .....	7,000	
Cash .....		10,000

9. The director decides that during the first six months of operation visitors to the museum will be asked for voluntary donations (not eligible to be counted toward the matching grant described in (7)). When WA begins organizing formal themed exhibitions in the second half of the year they will begin to charge a mandatory admissions fee of \$5 per visitor. During the first six months of 2019, 3,200 visitors came to the museum and voluntarily contributed \$11,267 to WA. During the second half of the year 4,000 paid visitors came to the museum.

Cash .....	31,267 <sup>4</sup>	
Admissions Revenue ...		31,267

10. One of the visitors, a wealthy local businessman, was excited by the impact that WA would have on the community and pledged \$500,000 (\$250,000 was paid on June 30, 2019 and the remaining \$250,000 was to be paid on June 30, 2021) to create an endowment whose earnings were to be used solely to purchase incremental pieces of art of the collection. The \$250,000 was immediately invested in a common stock mutual fund. The value of this fund was \$262,000 as of December 31, 2019. No new pieces of art were purchased during 2012. On December 15, 2019 Western received a check for \$5,000 representing dividends from the common stock investment.

Cash .....	250,000 <sup>5</sup>	
Contribution Receivable (LT).....	231,139 <sup>6</sup>	
Contribution Rev (PR).....		481,139
Investment (stock).....	250,000	
Cash .....		250,000
Cash .....	5,000	
Dividend revenue (TR).....		5,000

<sup>4</sup> 31,267 = 11,267 + 20,000

<sup>5</sup> This journal entry is made on 6/30/19 with the exception of the dividend revenue which is made on 12/15/19. The increase in the investment value will be recognized in the adjusting entries.

<sup>6</sup> 231,139 = (250,000)/(1.04)(1.04)

11. In December, 2019 WA decided to sell subscriptions for the coming year. Purchasing an entry pass for \$40 would entitle an individual to visit the museum any time during the year ending December 31, 2020. WA sold 100 such passes during the month of December, 2019.

Cash .....	4,000	
Deferred revenue .....		4,000

12. During the year ended December 31, 2019 the museum incurred miscellaneous costs in the amount of \$30,000 for insurance, utilities, marketing, phone, etc.. As of December 31, \$3,000 of these costs were not yet paid.

Misc. Expenses .....	30,000	
Cash .....		27,000
Accounts Payable.....		3,000

13. The mortgage was paid on time and there were no wages earned during 2019 which were not fully paid as of December 31, 2019. The accountant was fully paid and no incremental art was purchased or on loan from any other museum or individual.

Mortgage Payable.....	15,000	
Interest Expense .....	22,500 <sup>7</sup>	
Cash .....		37,500

Salary Expense .....	124,800 <sup>8</sup>	
Accounting Expense .....	50,000	
Cash .....		174,800

14. WA collected an additional \$24,000 in unrestricted contributions during the period from January 1, 2019 to June 30, 2019. During the second half of the year (July 1, 2019 to December 31, 2019). WA received \$32,000 in cash contributions without restrictions of any kind. The matching contributions were recorded.

Cash .....	56,000	
Contributions Rec (ST) .....	32,000	
Contribution Rev (UNR) .....		56,000
Contribution Rev (TR) .....		32,000 (match)

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<sup>7</sup> 22,500 = .05(450,000)

<sup>8</sup> 124,800 = (60,000 + 36,000)(1.3)

15. During December, 2019 the Director of WA made a trip to several individual collectors to begin plans to coordinate a show at WA which would feature several works from their private collections. The individuals were generally agreeable. The Director incurred \$2,200 in travel expenses (all paid in cash).

Travel Expense .....	2,200
Cash .....	2,200

### The t-accounts, adjusting and closing entries and financial statements

There are several adjusting entries necessary before we are able to construct the statements for the year.

A1. To recognize depreciation expense for the year.

Depreciation Expense .....	12,500
Accum. Depreciation .....	12,500 <sup>9</sup>

A2. To bring investment to fair market value.

Investment .....	12,000
Unrealized Gain on Invest.....	12,000

A3. To amortize the discount on long term contributions receivable described in item 1.

Contributions Receivable .....	18,491
Contribution Revenue (TR) ....	18,491 <sup>10</sup>

A4. The recognition of the matching contribution revenue recognized in item 14 above would most likely be made as an adjusting entry at the end of the period when the final number for unrestricted contributions was known. Just to emphasize what is going on in the background of the reporting process we would likely go to the conditional contributions list and update it for the contributions made and the matching amount now earned because the condition was satisfied—contributions were received. See Figure 3. 10.

A5. To amortize the discount for ½ year on the contribution to endow the purchase of art described in item 10.

Contribution Receivable .....	4,623
Contribution Revenue (PR)...	4,623 <sup>11</sup>

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<sup>9</sup> 12,500 = 500,000/40

<sup>10</sup> 18,491 = .04(462,278)

<sup>11</sup> 4,623 = .04(231,139)/2

A6. To recognize the transfer of restricted travel funds to unrestricted funds, as item 15 could be paid for out of these funds.

Net Assets (TR) ..... 2,200  
 Net Assets (UNR) ..... 2,200

**Figure 3.10 Internal Accounting Spreadsheet for Conditional Contributions**

CONDITIONAL CONTRIBUTIONS					
Amount	Donor	Use			CONDITION
		UR	TR	PR	
50,000	NAME	50,000			If 12,000 paying visitors during 2020 fiscal year
???	NAME	???	\$32,000 matched 7/1/19 to 12/31/19		Match all unrestricted contributions from 7/1/19 to 7/1/20

The following closing entries (labelled D) were made at the end of the year on 12/31/19. This first group closes all accounts related to Net Assets (UNR).

Contributions Revenue (UNR)..... 56,000  
 Admissions Revenue..... 31,267  
 Net Assets (UNR)..... 161,733  
     Depreciation Expense..... 12,500  
     Travel Expense..... 2,200  
     Supplies Expense..... 7,000  
     Accounting Expense..... 50,000  
     Miscellaneous Expenses..... 30,000  
     Interest expense..... 22,500  
     Salary Expense..... 124,800

This next group of closing entries closes all accounts related to Net Assets (TR).

Unrealized Investment Gain ..... 12,000  
 Contribution revenue (TR)..... 50,491  
 Dividend revenue..... 5,000  
     Net Assets (TR)..... 67,491

Finally, closing related to Net Assets (PR).

Contribution Revenue (PR)..... 485,762  
     Net Assets (PR)..... 485,762

Figure 3.11a through 3.11c show the Western t-accounts after closing entries have been entered on 12/31/19. The t-accounts are now ready to record transactions for the coming year of operations and the statements for the year can be constructed.

**Figure 3.11a: T-accounts (Assets and Liabilities)**

<b>Cash</b>			<b>Contribution Rec. (LT_TR)</b>		
BB	500,000		BB	462,278	
		10,000	8	10	231,139
9	31,267	250,000	10	A3	18,491
10	250,000	27,000	12	A5	4,823
10	5,000	37,500	13	EB	716,531
11	4,000	50,000	13		
14	56,000	124,800	13	<b>Contributions Rec. (ST)</b>	
		2,200	15	BB	-
EB	344,767		14	14	32,000
			EB	EB	32,000
<b>Building</b>			<b>Art</b>		
BB	500,000		BB	750,000	
EB	500,000		EB	750,000	
<b>Accum. Deprec.</b>			<b>Investment</b>		
		-	BB	BB	-
		12,500	A1	10	250,000
		12,500	EB	A2	12,000
				EB	262,000
<b>Inventory Supplies</b>			<b>Mortgage Payable</b>		
BB	-				450,000
8	3,000		13	13	15,000
EB	3,000				435,000
<b>Deferred Revenue</b>			<b>Accounts Payable</b>		
		-	BB		-
		4,000	11		3,000
		4,000	EB		3,000

The statement of activities for the year ended on December 31, 2019 can be found in Figure 3.12. Again, to emphasize, it resembles a for-profit statement of changes in shareholders' equity more so than an income statement as every item that changes net assets is included in the activities statement of a nonprofit. We shall see, not surprisingly, this may cause some confusion in defining exactly what operations are in some nonprofits.

A rather unique entry in the activities statement, which does not change net assets, is the transfer of net assets from one restricted category to another category. This usually happens when the nonprofit engages in an activity covered by the

restriction and it is a way of signaling that the restriction has been met in this period. In Figure 3.12 observe that there is a transfer of \$2,200 from the TR category to the UNR category. This was to pay for the \$2,200 of travel expenses to find new exhibition art, which was the intended activity to be funded by the gift.

We will go into detail in Chapter 4 about the allowable format and classification differences for each of the statements. For now we present one basic format for each statement. Western's statement of financial position appears in Figure 3.13.



**Figure 3.11b: T-accounts (Net Assets Accounts)**

Net Assets (UNR)				Net Assets (TR)			
		500,000	BB			512,278	BB
(D)	2,200	31,267	(D)	(A6)	2,200		
(D)	12,500	56,000	(D)			50,491	(D)
(D)	7,000					5,000	(D)
(D)	50,000					12,000	(D)
(D)	30,000					577,569	EB
(D)	22,500						
(D)	124,800	2,200	(A6)				
		340,467	EB				
Net Assets (PR)							
		750,000	BB				
		485,762	(D)				
		1,235,762	EB				

There is nothing unusual about this statement and looks very similar to a normal for-profit balance sheet. The one difference is the replacement of shareholders' equity with net assets. As we read in chapter 2, normal exchange transactions in a nonprofit are accounted for the way

they would be in for profit statements. So cash received for the purchase of admissions to the

**Figure 3.11c: T-accounts (Temporary Accounts)**

Contribution Rev (TR)				Contribution Rev (PR)			
		32,000	14			481,139	10
(D)	50,491	18,491	A3	(D)	485,762	4,623	A5
Contribution Rev (UNR)				Depreciation Expense			
		56,000	14	A1	12,500		
(D)	56,000					12,500	(D)
Admissions Rev.				Dividend Rev			
		31,267	9			5,000	10
(D)	31,267			(D)	5,000		
Travel Exp.				Supplies Exp			
15	2,200			8	7,000		
		2,200	(D)			7,000	(D)
Unreal. Investment Gain				Accounting Exp.			
(D)	12,000		A2	13	50,000		
		12,000				50,000	(D)
Misc. Exp.				Interest Exp.			
9	30,000			13	22,500		
		30,000	(D)			22,500	(D)
Salary Exp.							
13	124,800						
		124,800	(D)				

museum in the next fiscal year create liabilities in Western's balance sheet. We will also see later on that there are rules specific to nonprofit statement construction. For example, we alluded to the three different ways that collections can be reported in the statement of financial position. Under some general conditions most museums will not show the value of their collections on the statement of financial position. We will talk in detail about the accounting for collections in Chapter 5, but in the meantime just realize that there may be a zero in a museum balance sheet for the value of collections.

Finally, the direct method cash flow statement is presented in Figure 3.14. Nothing unusual in terms of format and general classification. The standard breakdown into operations, finance and investing uses and sources of cash. As we will see in the next

chapter some of the nonprofit classifications of which category a cash flow might go into are counter intuitive and we will have to take some time to get used to them.

**Figure 3.12 Western’s Statement of Activities for the year ending December 31, 2019<sup>12,13</sup>**

<b>MUSEUM OF WESTERN ART</b>			
Statement of Activities			
Year ending December 31, 2019			
	Without Donor Restrictions	With Donor Restrictions	TOTAL
CONTRIBUTIONS	56,000	50,491	106,491
INTEREST EXPENSE	(22,500)		(22,500)
DEPRECIATION	(12,500)		(12,500)
MISC. EXPENSES	(30,000)		(30,000)
SALARIES EXPENSE	(124,800)		(124,800)
ACCOUNTING EXPENSE	(50,000)		(50,000)
ADMISSIONS REVENUE	31,267		31,267
TRAVEL EXPENSE	(2,200)		(2,200)
SUPPLIES EXPENSE	(7,000)		(7,000)
TRANSFER	2,200	(2,200)	
<b>TOTAL FROM OPERATIONS</b>	<b>(159,533)</b>	<b>48,291</b>	<b>111,242</b>
NON OPERATING			
DIVIDEND REVENUE		5,000	5,000
UNREAL. INVESTMENT GAIN		12,000	12,000
CONTRIBUTIONS		485,762	485,762
<b>TOTAL-NONOPERATING</b>	<b>0</b>	<b>502,762</b>	<b>502,762</b>
<b>TOTAL CHANGE IN NET ASSETS</b>	<b>(159,533)</b>	<b>551,053</b>	<b>391,520</b>
BEGINNING NET ASSETS	500,000	1,262,278	1,762,278
ENDING NET ASSETS	340,467	1,813,331	2,153,798

<sup>12</sup> An unconditional promise to give, with payments due in future periods, are to be reported as restricted support. An exception is when the donor explicitly states that the support is to be used in the current period.

<sup>13</sup> Contributions received with temporary or permanent restrictions are usually reported in the restricted columns. However, if donor contributions have restrictions that are met in the same reporting period in which the contribution is received, the contribution may be reported as an unrestricted contribution, as long as similar contributions are reported consistently that way from period to period.

**Figure 3.13 Western’s Statement of Financial Position for the year ending December 31, 2019**

<b>MUSEUM OF WESTERN ART</b>			
Statement of Financial Position			
December 31, 2019			
CASH	344,767	A/P	3,000
CONTRIBS. REC. (ST)	32,000	DEFERRED REVENUE	4,000
INVENTORY	3,000		
CONTRIBS.REC.(LT)	716,531	MORTGAGE PAYABLE	435,000
INVESTMENT	262,000		
BUILDING	500,000	NET ASSETS:	
ACCUM. DEPREC.	(12,500)		
ART	750,000	Without donor restrictions	340,467
		With donor restrictions	1,813,331
		Total	2,153,798
TOTAL ASSETS	2,595,798	TOTAL LIAB + NET ASSETS	2,595,798

**Figure 3.14 Western’s Direct Method Cash Flow Statement for the year ending December 31, 2019**

<b>MUSEUM OF WESTERN ART</b>	
Statement of Cash Flows (Indirect)	
Year ending December 31, 2019	
<b>Cash flows from operating activities</b>	
Contributions	56,000
Admissions	35,267
Supplies	(10,000)
Miscellaneous	(27,000)
Interest	(22,500)
Pay accountant	(50,000)
Pay staff salaries	(124,800)
Travel	(2,200)
Cash provided by (used in) operations	(145,233)
<b>Cash flows from investing activities</b>	
Purchase of common stock for investment	(250,000)
Cash provided by (used in) investing activities	(250,000)
<b>Cash flows from financing activities</b>	
Contributions to endowment for purchases of art	250,000
Payment of mortgage	(15,000)
Dividend income for purchases of art	5,000
Cash provided by (used in) financing activities	240,000
Change in Cash	(155,233)
Beginning Cash	500,000
Ending Cash	344,767
<b>Supplemental cash flow information</b>	
Interest paid	22,500

Perhaps the most useful statement in analyzing financial statements is the indirect method cash flow statement presented in Figure 3.15. An explanation of the entries in the worksheet

**Figure 3.15 Western’s Indirect Method Cash Flow Worksheet for the year ending December 31, 2019**

MUSEUM OF WESTERN ART						
Statement of Cash Flows (Indirect worksheet)						
Year ending December 31, 2019						
	Beginning 12/31/2018				Ending 12/31/2019	
	DR	CR	DR	CR	DR	CR
Contr. Rec (ST)	0		(10) 32,000		32,000	
Building	500,000				500,000	
Accum. Depr.				12,500 (4)		12,500
Art	750,000				750,000	
Cont. Rec (LT)	462,278		(7) 235,762 (11) 18,491		716,531	
Supplies	0		(12) 3,000		3,000	
Investment	0		(5) 12,000 (9) 250,000		262,000	
Mortgage		450,000	(6) 15,000			435,000
A/P		0		3,000 (13)		3,000
Def. Rev.		0		4,000 (14)		4,000
NA-UNR		500,000	(1) 159,533			340,467
NA-TR		512,278		65,291 (2)		577,569
NA-PERM		750,000		485,762 (3)		1,235,762
		OPRNS	(2) 485,762	159,533 (1)		
			(3) 12,500	5,000 (8)		
				12,000 (5)		
			(14) 4,000	32,000 (10)		
			(2) 65,291	18,491 (11)		
			(13) 3,000	485,762 (7)		
				3,000 (12)		
				145,233		
		INVEST				
				250,000 (9)		
				250,000		
		FINANCE				
			(7) 250,000	15,000 (6)		
			(8) 5,000			
			240,000			
		Change in Cash	(155,233)			
		Beginning Cash	500,000			
		Ending Cash	344,767			

is given in Appendix A. Over the years we have realized that practicing constructing indirect method cash flow statements is great practice for developing an understanding how cash flows relate to accruals and therefore how accounting numbers relate to the true economic events that generated them. Finally the actual indirect method cash flow statement for Western is presented in Figure 3.16.

**Figure 3.16 Western’s Indirect Method Cash Flow Statement for the year ending December 31, 2019**

MUSEUM OF WESTERN ART Statement of Cash Flows (Indirect) Year ending December 31, 2019	
Change in net assets	391,520
Adjustments to reconcile change in net assets to net cash provided by (used in) operating activities	
Depreciation	12,500
Unrealized gain on investment	(12,000)
Permanently restricted contributions	(485,7620)
Dividends for purchase of art	(5,000)
Changes in operating assets and liabilities	
Contributions receivable (short term)	(32,000)
Contributions receivable (long term)	(18,491)
Supplies inventory	(3,000)
Accounts payable	3,000
Deferred admissions revenue	4,000
Cash provided by (used in) operations	(145,233)
Cash flows from investing activities	
Purchase of common stock for investment	(250,000)
Cash provided by (used in) investing activities	(250,000)
Cash flows from financing activities	
Contributions to endowment for purchases of art	250,000
Payment of mortgage	(15,000)
Dividend income for purchases of art	5,000
Cash provided by (used in) financing activities	240,000
Change in Cash	(155,233)
Beginning Cash	500,000
Ending Cash	344,767
Supplemental cash flow information	
Interest paid	22,500

Finally, although not an actual financial statement, we should update the internal worksheet for keeping track of restrictions and expected future payments relating to contributions which have been recognized. (as opposed to the earlier worksheet related to anticipated future contributions, once associated conditions have been met). This is presented below in Figure 3.17.

**Figure 3.17 Western’s Internal Accounting Spreadsheet for Contributions<sup>14</sup>**

CONTRIBUTIONS AND PLEDGES						
			Amount (present value)			
Contribution	Pledge	Donor	UR	TR	PR	Notes
500,000		Benefactor	500,000			Paid
	500,000	Benefactor		462+ 18,491		Due 1/1/21
750,000		Name			750,000	Permanent Collection
50,000		Name		50,000		Costs incurred to purchase new pieces of art (2,200 used to date)
250,000		Name			250,000	Create endowment for art purchases
	250,000	Name			231,139 + 4,623	Create endowment for art purchases

<sup>14</sup> Obviously there would be much more detailed information: phone numbers addresses in a data base, list of previous meetings and calls, etc.

## APPENDIX A: Explanation of Worksheet Entries in Figure 3.15

The following journal entries explain the worksheet entries in Figure 3.15, used to construct the indirect method cash flow statement. As always, we begin by estimating cash flow from operations by the changes in the three net asset categories. Of course, we might start with just using unrestricted and temporary restricted assets as our guess for cash flow from operations as we expect permanent assets to be more in the nature of capitalization of the nonprofit (e.g. endowment, collections, things that are always there). (1), (2), and (3) explain the changes in each category of net assets and assumes it is associated with an operating cash flow.

- |     |  |         |         |
|-----|--|---------|---------|
| (1) | Net Assets (UNR) .....   | 159,533 |         |
|     | Cash (OPRNS) .....   |         | 159,533 |
| (2) | Cash (OPRNS) .....   | 65,291  |         |
|     | Net Assets (TR) .....  |         | 65,291  |
| (3) | Cash (OPRNS) .....   | 485,762 |         |
|     | Net Assets (PERM).....   |         | 485,762 |
| (4) | This is the usual adjustment for depreciation expense which we know not to be a cash flow, but an increase to the accumulated depreciation account.  |         |         |
|     | Cash (OPRNS) .....   | 12,500  |         |
|     | Accumulated Depreciation .....   |         | 12,500  |
| (5) | The adjusting entry to write the investment to market did not involve cash at all and must be removed from the number in cash from operations, like depreciation but with the opposite sign) and entered into the investment account where it belongs.   |         |         |
|     | Investment .....   | 12,000  |         |
|     | Cash (OPRNS) .....   |         | 12,000  |
| (6) | Similarly, the payment of the mortgage has nothing to do with operations, it was a financing use of cash to pay down the mortgage.   |         |         |
|     | Mortgage .....   | 15,000  |         |
|     | Cash (FIN) .....   |         | 15,000  |
| (7) | The creation of the endowment earnings from which were to be used to purchase art, of which \$250,000 was received this year and the remainder with a present value of \$235,762 to be received in the future represent a permanent form of financing (like selling common stock in a for profit) and must be removed from operations. |         |         |

Cash (FIN) .....	250,000	
Contributions Rec (LT) .....	235,762	
Cash (OPRNS) .....		485,762

- (8) The dividend was to be used to finance building the permanent art collection and as such is non-operational.

Cash (FIN) .....	5,000	
Cash (OPRNS) .....		5,000

- (9) The \$250,000 cash in (7) was invested in a common stock mutual fund.

Investment .....	250,000	
Cash (INV) .....		250,000

- (10) Contributions receivable (ST) went up by \$32,000 during the year. This means that \$32,000 of contribution revenue was not received in cash. (This is analogous to accounts receivable increasing in a for profit firm).

Contributions Rec (ST) .....	32,000	
Cash (OPRNS) .....		32,000

- (11) Similar to (10) the increase in long term contributions receivable must be adjusted for.

Contributions Rec. (LT) .....	18,491	
Cash (OPRNS) .....		18,491

- (12) The increase in supplies inventory was paid for in cash and is an operational activity.

Supplies .....	3,000	
Cash (OPRNS) .....		3,000

- (13) The increase in accounts payable represents the amount of expense in the activity statement that was not paid for in cash even though it decreased net assets.

Cash (OPRNS).....	3,000	
Accounts Payable .....		3,000

- (14) Finally, the admissions fees paid in advance to Western which won't actually be earned by the museum until next year didn't increase net assets but did increase cash.

Cash (OPRNS) .....	4,000	
Deferred Revenue .....		4,000