Best Practices in Not-for-Profit Accounting and Reporting

BPN4/24/V1

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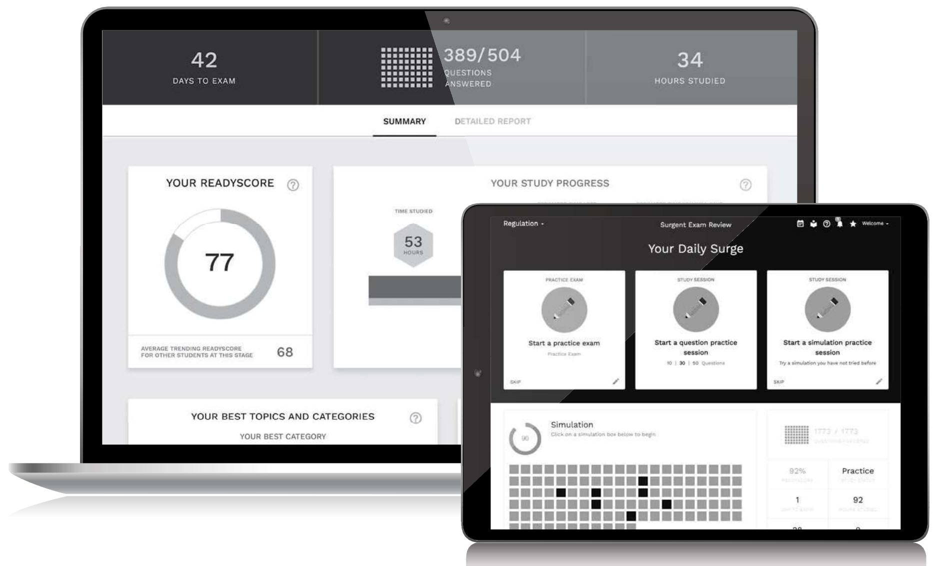

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Revised April 2024

Tell Me about Yourself

Tell Me about Yourself

Learning Objectives

Upon completing this chapter, you will be able to:

- Perceive the importance of understanding the NFP and its resource providers in designing financial statements which communicate the services an NFP provides and its ability to continue to provide those services; and
- Review key global issues related to presenting the financial statements.

I. Tell me about yourself

In the course of a job interview, it is not unusual for an interviewer to ask the applicant to “tell me about yourself.” Many job applicants dread that request as it can be difficult to describe one’s abilities and experiences in a limited amount of words. Not-for-profit entities (NFPs) are challenged with a similar dilemma when they prepare their financial statements. Using a limited amount of words, numbers, symbols, and formatting, the NFP attempts to present its abilities and experiences in serving its mission to financial statement users.

When we talk about financial statement presentation, presentation refers to the display of line items, totals, and subtotals on the financial statements. The line items, totals, and subtotals an NFP displays on its financial statements depict in words and numbers the elements of its financial statements (i.e., the assets, liabilities, net assets, revenues, expenses, gains, losses, as well as the cash flows of the NFP). The financial statement elements are the building blocks with which the financial statements are constructed. As discussed in the following chart, there are two different types of financial statement elements.

The two types of financial statement elements	
Point in time (i.e., ability) elements	**Period of time (i.e., experience) elements**
The first type of financial statement elements includes broad classes of assets, liabilities, and net assets, which describe resources or claims to or interests in resources at a specified date. These elements are emphasized in an NFP’s statement of financial position and speak to the NFP’s **ability** to fulfill its mission at a given point in time.	The second type of financial statement elements include broad classes of revenues, expenses, gains, and losses which convey the effects of transactions and other events and circumstances that affect an NFP. These elements are emphasized in an NFP’s statement of activities, statement of functional expenses (or its disclosure) and statement of cash flows. This information speaks to the NFP’s **experience** in fulfilling its mission over a period of time.
Note. In addition to the above financial statement elements, the notes to the financial statements amplify and complement information about the elements in the financial statements.	

A. Who are we speaking to?

An NFP's financial statements are a principal means of communicating financial information to those outside the entity. The financial statements are directed toward the common interest of different resource providers, and that is generally possible only because resource providers often have similar needs. The overall goal for a NFP in preparing its financial statements is to present faithful, relevant and understandable information that is capable of making a difference in the decisions made by resource providers. For example, do the financial statements present information that is useful in making decisions to commit (or continuing to commit) resources to an NFP? While resource providers are often the primary users of an NFP's financial statements, they are not the only users. The following chart discusses the primary users of the financial statements and their key informational needs.

<table>
<tr><th colspan="2">The primary users of NFP financial statements and their key informational needs</th></tr>
<tr><td>Resource providers</td><td>Donors, grantors, and members of an NFP are interested in the services that the entity provides and its ability to continue to provide those services. Since profit indicators are not the focus of their resource allocation decisions, an NFP needs to provide other information to assess the entity's performance during a period and how its managers have discharged their stewardship responsibilities, not only for the custody and safekeeping of the entity's resources but also for their efficient and effective use. This includes information about the amounts and kinds of inflows and outflows of resources during a period and the relationship of those resources with other information about service efforts.

Lenders, suppliers, and employees are also resource providers to NFPs. They view the NFP as a source of payment for the cash, goods, or services they supply. They desire information about the NFP's ability to generate cash flows for timely payment of the entity's obligations to them.</td></tr>
<tr><td>The public</td><td>The general public, or segments of the general public, use and benefit from the services rendered by NFPs. For some NFPs, the public includes resource providers (e.g., members who pay dues, patrons who buy tickets to performances, etc.). The public also includes the American taxpayer who supports NFPs by providing taxes (which may flow to NFPs in form of grants) and allows for NFPs to have preferential tax status. The public further includes beneficiaries of services provided by NFPs.

The public shares an interest in similar information to what resource providers' desire (i.e., information about the services that the NFP provides and its ability to continue to provide those services). However, regulatory bodies (representing the public) may certainly have unique informational needs that they impose.</td></tr>
<tr><td>Those charged with governance</td><td>Those charged with governance are responsible for setting policies and for overseeing and assessing management of an NFP. They also have a responsibility related to the NFP's compliance with various laws, restrictions, guidelines, or other items of a similar nature. While those charged with governance often have access to information outside the financial statements (e.g., the ability to directly question management, monthly budget-to-actual comparisons, and etc.), they still desire information provided in the financial statements. Particularly information that assists in evaluating management and seeing the need to change or formulate new policies for the NFP.</td></tr>
</table>

The primary users of NFP financial statements and their key informational needs	
Management	Management is responsible for carrying out the policy initiatives of those charged with governance and managing the day-to-day operations of an NFP. Management includes those charged with overseeing the NFP's programs, administrative functions, and fundraising. Financial information is important to management in evaluating the progress towards the responsibilities for which they are accountable to governing bodies, resource providers, and others. For example, a skilled fundraising manager should be able to utilize the information provided in the financial statements to convey the services provided by the NFP and the need for additional resources to donors.

B. Exercise 1-1

Please answer the following question.

How do we do this?

How can an NFP ensure that its financial statements meet all the information needs of resource providers, the public, those charged with governance, and management?

C. Fine-tuning the message to the audience

As we have discussed, NFPs should focus on presenting faithful, relevant and understandable information that is capable of making a difference in the decisions made by resource providers. While there are certain distinguishing characteristics that NFPs share [e.g., the absence of ownership interest(s) in the same sense as a business entity; operating purposes not centered on profit; and significant receipts of contributions, many involving donor-imposed restrictions] the resource providers of NFPs often differ. In developing NFP GAAP, the FASB recognized this and provided NFPs a good amount of flexibility and options in terms of how they present their financial statements to meet the needs of various resource providers.

Fine-tuning the message to the audience

Examples of options that NFPs have in how they present their financial statements to meet the needs of various resource providers include: (1) the titles used for the financial statements; (2) whether to present comparative information; (3) where information regarding board-designations is presented; (4) where information regarding donor-restrictions is presented; (5) whether a classified statement of financial position is presented; (6) whether functional or natural information is emphasized in the statement of activities; (7) the level of detail provided regarding program activities; (8) where functional and natural expense information is presented; (9) whether the statement of activities includes an operating measure; (10) whether the statement of activities utilizes the columnar or pancake approach; (11) whether the statement of cash flows is prepared using the direct or indirect method; and (12) the level of detail provided within the financial statements and notes.

D. How we pick the right options

We have briefly discussed the importance of considering the resource providers that the NFP is trying to reach and the options allowed under NFP GAAP in meeting their informational needs. That begs the question "how does an NFP pick the right presentation options in preparing their financial statements?"

In selecting the right presentation options for their financial statements, NFPs should consider…		
1st	**2nd**	**3rd**
What is the general nature of the NFP and who are its primary resource providers?	**What are the informational needs of the NFP's resource providers?**	**What types of information can financial reporting provide to meet those needs?**
For example, NFP X is primarily a fee-based NFP which receives minimal contributions. NFP X's primary resource providers include lenders.	The informational needs of NFP X's resource providers are comparable to those of a commercial entity. They are particularly concerned about NFP X's liquidity, its debt load, and its ability to generate revenue over expenses. They are not as concerned about mission fulfillment.	NFP X may want to consider: [1] presenting a classified statement of financial position; [2] including an operating measure in the statement of activities; [3] using natural expense information in the statement of activities; [4] preparing a direct method statement of cash flows; and [5] providing more extensive liquidity disclosures.

E. Exercise 1-2

NFP Z is trying to select the right presentation options for its financial statements. Please complete the following chart to assist NFP Z in selecting the right options. Remember, there are no concrete right or wrong answers here. It is a matter of your judgment and taste.

In selecting the right presentation options for their financial statements, NFPs should consider…		
1st	**2nd**	**3rd**
What is the general nature of the NFP and who are its primary resource providers?	**What are the informational needs of the NFP's resource providers?**	**What types of information can financial reporting provide to meet those needs?**
NFP Z is primarily a membership dues-based NFP. Members' dues fund multiple programs at NFP Z. NFP Z also provides certain services to members for additional fees. NFP Z raises a small amount of contributions each year and does not have any significant lenders.		

II. A few additional points to consider…

In the remainder of the course, we are going to stroll through the general-purpose financial statements that NFPs prepare and review best accounting and reporting practices that hopefully catch the eye of resource providers. However, before closing this section of the course, we wanted to review a few areas that apply globally to the financial statements.

A. GAAP or cash basis

In preparing their financial statements, NFPs must decide upon the basis of accounting to be used. From a theoretical standpoint, there are clearly benefits to the accrual basis of accounting. However, for certain NFPs, the cash basis of accounting may make sense. The following table reflects the strengths and weaknesses of the GAAP (i.e., accrual) basis and cash basis of accounting.

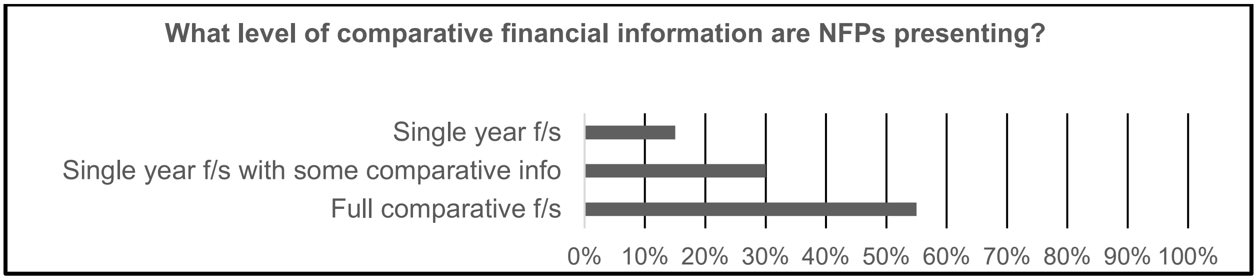
Key strengths and weaknesses of the GAAP basis and cash basis of accounting for NFPs	
GAAP basis strengths	**Cash basis strengths**
• Provides the financial effects of transactions, events, and circumstances that have consequences for an NFP in the periods in which those transactions, events, and circumstances occur rather than in only the periods in which cash is received or paid by the NFP (e.g., we recognize unconditional promises to give when received rather than paid); • It recognizes that the acquisition of resources needed to provide services and the rendering of services by an NFP during a period often do not coincide with the cash receipts and payments of the period (e.g., fixed assets are capitalized and then depreciated over time with the costs allocated to the functions of the NFP to fully reflect the costs of a given function); and • Provides faithful, relevant and understandable information to resource providers	• Allows an NFP to prepare its financial statements essentially in the same manner as it maintains its check book; • Ease of preparation (e.g., avoiding year-end accruals, fixed assets and depreciation, promises to give, etc.); and • May work fine for small NFPs where the primary financial statement users are management and those charged with governance
GAAP basis weaknesses	**Cash basis weaknesses**
• More work than cash basis	• Does not provide a full indication of an NFP's performance to financial statement users; and • De-emphasizes the importance of capital assets

1. What are other NFPs doing?

In developing this course, the author reviewed the audited financial statements of 100 NFPs. The NFPs selected consisted of both large and small entities, involved a wide variety of types of entities, and were audited by both small and large CPA firms. In terms of the basis of accounting used to prepare the financial statements, 100% of the NFPs reviewed used the GAAP basis of accounting. Admittedly, this percentage was likely affected by the fact the author was looking at audited financial statements. If the sample had included compiled financial statements of some smaller NFPs, the cash basis would likely have been encountered.

B. Comparative financial statements

GAAP does not require NFPs to present comparative financial statements. While some NFPs present complete comparative information, many NFPs opt to present comparative information for the prior year in total, rather than by net asset class. Furthermore, some NFPs simply choose to present single year financial statements without comparative information. While some resource providers may prefer comparative information, other resource providers are neutral on the topic and in those cases single year financial statements may have benefits (e.g., in years when significant accounting standards are being implemented like FASB ASC 842 on leases). The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course.



1. Exercise 1-3

Please answer the following question.

Is this enough?
An NFP is considering adding a total column with prior year information in the statement of activities (but not presenting revenues, expenses, gains, and losses by net asset class). If the summarized financial information is labeled "for comparative purposes only" is that all the NFP needs to do?

C. Global thoughts about disclosures

Throughout this course, we will discuss certain key disclosures to the financial statements. However, there are a few concepts that should be thought of globally when it comes to NFP disclosures.

1. Striking the right balance in referencing individual disclosures

In the audited financial statements of 100 NFPs the author reviewed for the course, some NFPs included parenthetical references to related individual disclosures on the face of the financial statements while other NFPs did not. While not referencing the related disclosures may increase the focus on the numbers themselves, it also makes it very difficult for users to locate the related information and perhaps much less likely that they will look at the notes to begin with (which is always a risk). In the author's opinion, a balance needs to be struck between including references for the most critical disclosures the NFP wants its users to see while not trying to include references to every single note. As illustrated in the following, including too many references can become a distraction in the financial statements.

Too many footnote references can become a distraction

ASSETS		
Cash and cash equivalents (Notes 2D and 15)	$ 1,768,100	$ 2,219,313
Investments, at fair value (Notes 2E, 4, 10A and 10C)	26,298,992	27,404,380
Accounts receivable, net (Note 2F and 17)	8,284,798	4,932,298
Contributions receivable, net (Notes 2C and 5)	3,761,007	2,424,478
Prepaid expenses and other (Note 12)	462,078	321,076
Property and equipment, net (Notes 2G and 6)	2,638,445	2,529,620
TOTAL ASSETS	$ 43,213,420	$ 39,831,165

2. The importance of the first footnote

Traditionally, the first footnote to the financial statements includes an overview of the NFP. This is an important branding opportunity to verbally describe the NFP and its mission to resource providers. In some cases, a potential donor may come across the financial statements without an accompanying narrative annual report and the first footnote may be all they have to go on in terms of understanding what the NFP is and what it does.

The importance of the first footnote

The below is a good example of describing what the NFP is and what it does:

[redacted] is a hunger relief organization that distributes donated, purchased and prepared foods through a network of more than 200 partner agencies in 13 counties. The Organization supports the nutritional needs of children, families and seniors through education, advocacy and strategic partnerships. The Organization's revenues and other support are derived principally from contributions and federal and state grants and its activities are conducted principally in the North Texas area.

The importance of the first footnote
The below is an example of an NFP perhaps selling itself short:

Organization

[redacted] is a non-profit corporation established in October 2002. The Church is supported primarily through contributions from the congregation.

3. The importance of the order of the footnotes

In addition to looking at the wording and level of detail provided in disclosures, NFPs should consider the order in which the footnotes appear. If certain disclosures are potentially more important to resource providers than others, those disclosures should not be buried at the back of the footnotes where they may be overlooked. For example, if a well-written disclosure of contributed services may impress potential donors to the NFP, the NFP should not bury that disclosure as footnote Z or 24 to the financial statements. Remember the importance of placement.

D. Being bold can be good or bad

In the audited financial statements of 100 NFPs the author reviewed for the course, the author noted the propensity of some NFPs to make their financial statements look just like other NFPs. This is understandable as there can certainly be safety in numbers. However, sometimes being bold in your formatting can make your financial statements stand out to resource providers. NFPs should consider who their resources providers are and whether they would be impressed or not impressed in making their financial statements unique from a formatting perspective.

Example of formatting boldness (putting the statement titles at the bottom of the statement)

Changes in federal student loan advances		(405)	(633)
NET CASH PROVIDED BY FINANCING ACTIVITIES		27,585	96,430
NET CHANGE IN CASH AND CASH EQUIVALENTS		(1,803)	(9,487)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		17,604	27,091
CASH AND CASH EQUIVALENTS AT END OF YEAR	$	15,801	17,604
OTHER CASH FLOW INFORMATION:			
Cash paid for interest	$	14,870	12,396
Change in accounts payable related to property and equipment		1,338	(484)
Right of use assets acquired under operating leases		1,909	—

See accompanying notes to financial statements.

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2021

(in thousands of dollars)

- *with comparative financial information for the year ended June 30, 2020*

III. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

A. Suggested solution to Exercise 1-1

How do we do this?
How can an NFP ensure that its financial statements meet all the information needs of resource providers, the public, those charged with governance, and management?
Quite often when discussing financial statements, we refer to them as the **general purpose financial statements**. However, "**general purpose**" does not mean "**all purpose**," and a given NFP's financial statements will not necessarily satisfy all resource providers or other possible users equally well. Rather than trying to overly complicate their financial statements and disclosures by trying to be everything for everyone, NFPs should remember that certain user groups have access to additional financial information outside the general purpose financial statements [e.g., management, those charged with governance, and regulators (representing the public)]. Instead, NFPs should primarily focus on presenting faithful, relevant and understandable information that is capable of making a difference in the decisions made by resource providers.

B. Suggested solution to Exercise 1-2

In selecting the right presentation options for their financial statements, NFPs should consider…		
1st	**2nd**	**3rd**
What is the general nature of the NFP and who are its primary resource providers? NFP Z is primarily a membership dues-based NFP. Members' dues fund multiple programs at NFP Z. NFP Z also provides certain services to members for additional fees. NFP Z raises a small amount of contributions each year and does not have any significant lenders.	**What are the informational needs of the NFP's resource providers?** NFP Z's primary resource providers are dues paying members. They have a natural interest in the different levels of services (i.e., programs) that NFP Z is providing to members for their dues and the additional fees being raised. They also have an interest in the level of resources NFP Z is accumulating or not accumulating.	**What types of information can financial reporting provide to meet those needs?** NFP Z may want to consider: [1] presenting information about designations and restrictions in the notes and using the pancake format for the statement of activities (as contributions are not significant); [2] not classifying the statement of financial position (as users are likely not that interested in the information); [3] presenting functional expense information in the statement of activities and breaking out NFP Z's multiple programs (so members can see where their dues are going); [4] presenting a statement of functional expenses (rather than disclosing this information in the notes); and [5] preparing an indirect method statement of cash flows (as it's easier).

C. Suggested solution to Exercise 1-3

Is this enough?

An NFP is considering adding a total column with prior year information in the statement of activities (but not presenting revenues, expenses, gains, and losses by net asset class). If the summarized financial information is labeled "for comparative purposes only" is that all the NFP needs to do?

No. Under FASB ASC 958-205-45-8, if the prior year's financial information is summarized, the nature of the prior-year information is required to be described **by the use of appropriate titles on the face of the financial statements** and **in a note to the financial statements**. The use of appropriate titles includes a phrase such as "with summarized financial information for the year ended June 30, 20X1", following the title of the statement or column headings that indicate the summarized nature of the information. Labeling the prior-year summarized financial information "for comparative purposes only" without further disclosure in the notes to financial statements would not constitute the use of an appropriate title. Typically, the wording of the note would say something like "The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with GAAP. Accordingly, such information should be read in conjunction with the NFP's financial statements for the year ended June 30, 20X1, from which the summarized information was derived."

The Statement of Financial Position

The Statement of Financial Position

Learning Objectives

Upon completing this chapter, you will be able to:

- Perceive key issues related to the statement of financial position; and
- Understand how the statement of financial position can be tailored to fit the NFP and meet the needs of resource providers.

I. The statement of financial position

As discussed in the following chart, the statement of financial position speaks to the NFP's ability to fulfill its mission at a given point in time.

A snapshot of the NFP's ability to fulfill its mission

The statement of financial position (and its accompanying notes) provides a snapshot of what an NFP's assets, liabilities, and net assets looked like at a given point in time. The information provided in the statement is essential for understanding the NFP's ability to fulfill its mission and the need for additional resources. Resource providers can utilize the statement and accompanying notes to assess: (1) the NFP's liquidity, financial flexibility, ability to meet obligations, and needs for external financing; (2) the effects, if any, of the limits on the use of resources imposed by an NFP's governing board, donors, grantors, laws, and contracts; and (3) how management has satisfied its stewardship responsibilities and other aspects of its performance.

A. Naming options

The statement of financial position is the financial statement of an NFP that resembles the balance sheet of a business entity. In fact, some NFPs prefer to use the title **balance sheet** instead of **statement of financial position** as that terminology may be more comfortable to board members. The use of either title is appropriate. In the audited financial statements of 100 NFPs that the author reviewed for the course, 88% of NFPs used the **statement of financial position** title and 12% used the **balance sheet** title.

II. Key concepts related to the statement of financial position

In this section of the course, we want to explore some basic key concepts related to the statement of financial position. While the statement of financial position may resemble the balance sheet of a business entity, there are certainly some differences particularly in the equity section. For example, because NFPs have an absence of ownership interests like those of business entities, they do not have traditional equity accounts like retained earnings and common stock. Instead, NFPs utilize net assets to account for the equity portion of their statement of financial position.

A. The statement of financial position shall report…

FASB ASC 958, *Not-for-Profit Entities*, requires that the statement of financial position report certain amounts.

The statement of financial position focuses on the NFP as a whole and reports all of the following amounts:

Statement of Financial Position

- **Total assets**
- **Total liabilities**
- **Total net assets without donor restrictions**
- **Total net assets with donor restrictions**
- **Total net assets**

1. Exercise 2-1

Please answer the following true or false question.

		True or False
1	If an NFP only had net assets without donor restrictions, on the face of its statement of financial position, it must show a line item “Total net assets with donor restrictions” and a dash or zero for the amount.	

B. Flexibility in formatting

As discussed below, NFPs have flexibility in the format used for the statement of financial position.

NFPs have flexibility in the format used for the statement of financial position

FASB ASC 958 does not emphasize or prevent specific statement formats used for the statement of financial position. It permits a left-to-right (i.e., with assets on the left side **and** liabilities and net assets on the right side) or top-to-bottom balanced format (i.e., with assets listed first, followed by liabilities and net assets) as well as single-column, multicolumn, single-page, or multipage formats.

Benefits to using a **top-to-bottom format** (i.e., with assets listed first, followed by liabilities and net assets) include: (1) it’s friendly to presenting comparative information as an additional column; (2) it makes it clear that assets less liabilities equals net assets; and (3) ease of formatting. Benefits to using a **left-to-right format** (i.e., with assets on the left side and liabilities and net assets on the right side) include: (1) it emphasizes that assets balance with liabilities and net assets; and (2) it works well when an NFP includes many line items of assets, liabilities and net assets **or** presents a classified statement. One drawback to the left-to-right format is that it sometimes results in unusual spacing issues on the statement (e.g., large gaps of blank space on the asset side).

The left-to-right format can result in large gaps of blank space

Assets		**Liabilities and Net Assets**	
Current Assets		Current Liabilities	
Cash	$ 7,793,413	Current maturities of bonds payable, net	$ 1,729,007
Accounts receivable, net	1,411,475	Accounts payable	504,624
Grants receivable	910,650	Accrued expenses	3,337,239
Prepaid expenses	929,864		
Inventories	2,664,958	Total Current Liabilities	5,570,870
Land available for sale	1,860,990		
		Long-term Liabilities	
Total Current Assets	15,571,350	Bonds payable, less current maturities, net	24,533,648
		Other non-current liabilities	586,431
Property and Equipment, net	74,141,097		
			25,120,079
Other Assets			
Investments	41,350,917	Total Liabilities	30,690,949
Funds held in trust by others	191,807		
Certificates of deposit, net	98,837	Net Assets	
Deposits	53,324	Without donor restrictions	
		Undesignated	18,161,462
	41,694,885	Board designated endowment	18,757,579
		Board designated for strategic capital initiatives	15,740,487
		Invested in property and equipment	47,878,442
		Total Net Assets Without Donor Restrictions	100,537,970
		With Donor Restrictions	178,413
		Total Net Assets	100,716,383
Total Assets	$ 131,407,332	Total Liabilities and Net Assets	$ 131,407,332

1. Exercise 2-2

Please answer the following true or false question.

		True or False
1	The majority of NFPs utilize the left-to-right format for the statement of financial position.	

C. Aggregating assets and liabilities that possess similar characteristics

It is important that the statement of financial position properly aggregates assets and liabilities.

	Aggregating assets and liabilities that possess similar characteristics
$$$$ $$$$ $$$$ $$$$ $$$$ $$$$	A statement of financial position, including accompanying notes to financial statements, provides relevant information about liquidity, financial flexibility, and the interrelationship of an NFP's assets and liabilities. That information generally is provided by aggregating assets and liabilities that possess similar characteristics into reasonably homogeneous groups that include the effects of donor-imposed restrictions as well as other contractual restrictions.

Classifying and aggregating items with similar characteristics into reasonably homogeneous groups and separating items with differing characteristics improves the usefulness of information. For example, entities generally report individual items of assets in homogeneous groups, such as cash and cash equivalents; accounts and notes receivable from patients, students, members, and other recipients of services; inventories of materials and supplies; deposits and prepayments for rent, insurance, and other services; marketable securities and other investment assets held for long-term purposes; and land, buildings, equipment, and other long-lived assets used to provide goods and services. Similarly, cash collections of receivables from patients, students, or other service recipients may differ significantly in continuity, stability, and risk from cash collections of pledges made to a special-purpose fundraising campaign. Classifying and reporting those receivables and collections of receivables as separate groups of assets and of cash inflows assists in financial statement analysis.

Donor restrictions and asset classifications

Assets may be restricted by donors. Normally, however, restrictions apply to net assets, not to specific assets. Assets need not be disaggregated on the basis of the presence of donor-imposed restrictions on their use (e.g., cash available for current use and without donor restrictions need not be reported separately from cash received with donor-imposed restrictions ***that is also available for current use***). However, cash or other assets received with a donor-imposed restriction ***that limits their use to long-term purposes*** should not be classified with cash or other assets that are without donor restrictions and are available for current use. If the nature of the restriction or designation (i.e., amount and purpose) is not clear from the description on the face of the statement of financial position, the kind of asset whose use is limited either by a donor-imposed restriction or by governing board designations should be described in the notes to the financial statements.

The following information is required to be displayed either on the face of the statement of financial position or in the notes, unless otherwise required on the face of the statement of financial position: [1] relevant information about the nature and amount of limitations on the use of cash and cash equivalents (e.g., cash held on deposit as a compensating balance); and [2] contractual limitations on the use of particular assets (e.g., restricted cash or other assets set aside under debt agreements, assets set aside under self-insurance funding arrangements, assets set aside under collateral arrangements, or assets set aside to satisfy reserve requirements that states may impose under charitable gift annuity agreements).

1. Striking the right level of detail in the line items shown on the statement of financial position

NFPs should consider the level of detail that they are presenting within the statement of financial position and the notes. This can be a real balancing act involving considering the type of NFP involved and the information their resource providers' desire. Too little information can leave resource providers with questions and too much information can lose the reader.

Perhaps an example of too little information provided

This audited GAAP basis statement of financial position had no liabilities. This is unusual and a resource provider might have expected a discussion of this in the notes and none was presented.

Assets	
Current assets	
Cash and cash equivalents	$ 46,696
Investments	62,544
Contributions receivable	360
Prepaid programming	8,845
Total current assets	118,445
Property, plant and equipment, net	130,470
	$ 248,915
Net Assets	
Without donor restrictions	
Undesignated	$ 186,371
Board-designated endowment	6,502
With donor restrictions	
Perpetual in nature	56,042
Total net assets	$ 248,915

Perhaps an example of too much information provided

This NFP went into a lot of detail in terms of the line items devoted to property and equipment on its statement of financial position which can cause some financial statement users to lose interest. If the NFP wanted to simplify its presentation, it could use one line item (e.g., “Property and equipment, net” or “Fixed assets, net”) and present the below detail in the notes.

Property and equipment		
Land	120,000	120,000
Buildings and improvements	2,144,929	2,073,872
Building equipment (portable)	55,649	51,313
Furniture for property/resident use	10,007	10,007
Furnishings	114,350	76,219
Office Furniture and Equipment	16,847	16,847
Construction in progress	-	12,660
	2,461,782	**2,360,918**
Less: Accumulated depreciation	(1,494,042)	(1,402,101)
Total property and equipment, net	**967,740**	**958,817**

The following example is from a large NFP which goes to great lengths to simplify the statement of financial position.

An example of simplifying the statement of financial position

This large NFP (the below amounts are in thousands) believes its resource providers want to see a simplified statement of financial position.

Assets		
Cash and cash equivalents	$ 31,511	$ 25,491
Accounts receivable and other assets, net	57,383	53,165
Pledges receivable, net	190,527	226,827
Investments	6,772,836	7,078,812
Property and equipment, net	1,372,298	1,294,089
Total assets	$ 8,424,555	$ 8,678,384
Liabilities		
Accounts payable and other liabilities	$ 136,440	$ 159,420
Notes and bonds payable	1,134,476	950,496
Actuarial liability for life income agreements	125,668	135,602
Government refundable advances	3,218	5,082
Total liabilities	1,399,802	1,250,600
Net Assets		
Without donor restrictions	3,213,202	3,410,997
With donor restrictions	3,811,551	4,016,787
Total net assets	7,024,753	7,427,784
Total liabilities and net assets	$ 8,424,555	$ 8,678,384

2. Exercise 2-3

Please answer the following question related to the individual lines items used on the statement of financial position.

How will an NFP know the right level?

How can an NFP ensure that its statement of financial position provides the right level of detail?

D. Unique items appearing on the statement of financial position

As we stated earlier, the statement of financial position is the financial statement of an NFP that resembles the balance sheet of a business entity. However, there certainly are some differences. In this section, we will briefly discuss some of the unique items (contributions, net assets, and collections) which may appear on an NFP's statement of financial position and some of the key accounting requirements related to them.

1. Contributions

In an NFP, assets are used to provide desired or needed goods or services to beneficiaries or other constituents, which may or may not directly result in net cash inflows to the entity. Some NFPs rely significantly on contributions or donations to supplement selling prices or to replace cash or other assets used in providing goods and services. The following chart summarizes key accounting guidance related to contributions.

Key summarized accounting guidance related to contributions	
	A **contribution** is an **unconditional** transfer of cash or other assets, as well as **unconditional promises to give**, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary **nonreciprocal** transfer by another entity acting other than as an owner.
	Unconditional contributions are recorded at fair value when received. If an unconditional promise to give is expected to be collected in less than one-year, net realizable value (i.e., the face value of the promise net of any estimated uncollectible amount) may be used. If the expected collection is more than one-year, present value techniques are incorporated.
	Conditional contributions have **both** a barrier **and** a right of return of assets transferred or a right of release of a promisor's obligation to transfer assets. If both are present, revenue would not be recognized until the barrier is overcome. If assets are received in advance of satisfying the conditions a refundable advance liability is recorded.
	Transactions in which commensurate value is exchanged are exchange transactions not contributions. Societal benefit, execution of a resource provider's mission or the positive sentiment from acting as a donor are not commensurate value. Payments from a third-party payer on behalf of an existing exchange transaction between the NFP and an identified customer are not contributions (e.g., Medicare and Medicaid payments, Pell grants, etc.).
	Donors may place time or purpose restrictions on contributions. Such donor-imposed restrictions limit the use of the contribution, but they do not change the transaction's fundamental nature from that of a contribution (i.e., contributions with donor-imposed restrictions are recognized as revenues or gains in the period received).
	Certain contributed services qualify as contributions (i.e., if they create or enhance nonfinancial assets; require specialized skills, are provided by individuals with those skills, and the NFP would typically need to purchase those skills; or are provided by affiliates to benefit the NFP and the affiliate does not charge the recipient NFP).
	Contributed nonfinancial assets received have additional presentation and disclosure requirements.

2. Net assets

Net assets represent the residual interest in the assets of an NFP that remains after deducting its liabilities. Net assets of NFPs are divided into two mutually exclusive classes - **net assets with donor restrictions** and **net assets without donor restrictions**. The classification of net assets is based on the presence or absence of donor-imposed restrictions. Information about restrictions on net assets is important to the readers of NFP financial statements whether they be internal or external users. Donor restrictions impose distinct responsibilities on an NFP's management to ensure that it uses donated assets as stipulated. Donor restrictions also place limits on the use of resources which may have a bearing on an NFP's performance and its ability to provide a satisfactory level of services. Information about how managers discharge their stewardship responsibilities for donor-restricted resources is also helpful in assessing an NFP's performance.

Under FASB ASC 958, NFPs present the total amounts for two classes of net assets (i.e., **net assets without donor restrictions** and **net assets with donor restrictions**) as well as total net assets on the face of the statement of financial position. The two classes of net assets are summarized below.

A summarized view of the FASB ASC 958 classification of net assets

Net assets without donor restrictions	+	**Net assets with donor restrictions**	=	**Total net assets**
[i.e., the part of net assets of the NFP that is **not subject to** donor-imposed restrictions (donors include other types of contributors, including makers of certain grants)]		[i.e., the part of net assets of the NFP that is **subject to** donor-imposed restrictions (donors include other types of contributors, including makers of certain grants)]		[i.e., the excess or deficiency of assets over liabilities of the NFP which is divided into two mutually exclusive classes according to the existence or absence of donor-imposed restrictions]

3. Collections

Some NFPs maintain collections and receive contributions of works of art, historical treasures, and similar items for a collection. **Collections** are works of art, historical treasures, or similar assets that meet all of the following criteria: (1) they are held for public exhibition, education, or research in furtherance of public service rather than financial gain; (2) they are protected, kept unencumbered, cared for, and preserved; and (3) they are subject to an organizational policy that requires the use of proceeds from items that are sold to be for the acquisitions of new collection items, the direct care of existing collections, or both.

The recognition and measurement principles for contributions of collection items depend on the collections-capitalization policy adopted by the NFP. Contributions of works of art, historical treasures, and similar items that are not part of a collection are recognized as assets and as revenue or gains. An NFP need not recognize contributions of works of art, historical treasures, and similar assets if the donated items are added to collections that meet all three of the criteria in the definition of a collection. Contributed collection items are recognized as revenues or gains if collections are capitalized and are not recognized as revenues or gains if collections are not capitalized. An NFP that does not recognize and capitalize its collections or that capitalizes collections prospectively does have additional disclosure requirements.

III. To classify or not classify…

Later, we will discuss requirements that NFPs have related to providing information about an NFP's available resources and also information useful in assessing its liquidity. However, right now we want to discuss more traditional liquidity information that NFPs provide and the decision NFPs face with regard to whether or not they should prepare a classified statement of financial position.

FASB ASC 958 requires that information about the NFP's liquidity be provided by any of the following three methods:	
	Sequencing assets according to their nearness of conversion to cash and sequencing liabilities according to the nearness of their maturity and resulting use of cash.
	Classifying assets and liabilities as current and noncurrent (i.e., presenting a classified statement of financial position), as defined by FASB ASC 210-10.
	Disclosing in notes to financial statements any additional relevant information about the liquidity or maturity of assets and liabilities, including restrictions on the use of particular assets.

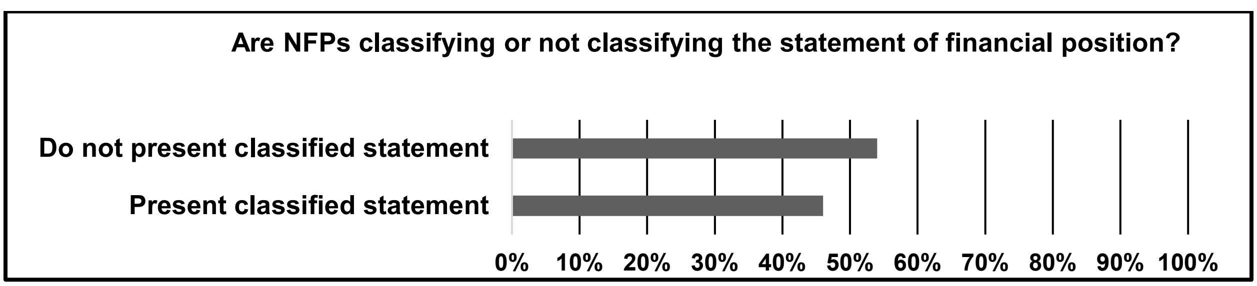
A. Exercise 2-4

Please answer the following true or false questions.

		True or False
1	NFP business-oriented health care entities are required to present a classified balance sheet.	
2	On its statement of financial position NFP Z wants to classify its assets as current and noncurrent. However, instead of classifying its liabilities as current and noncurrent, NFP Z wants to sequence its liabilities according to the nearness of their maturity and resulting use of cash. This is a good idea.	

B. What are NFPs doing?

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course.



C. Exercise 2-5

Please answer the following question related to preparing a classified statement of financial position.

To classify or not classify…	
NFP Z is not a business-oriented health care entity. NFP Z is trying to weigh some of the pros and cons to presenting a classified statement of financial position. Please complete the below to assist NFP Z in making its decision.	
Pros to classifying	**Cons to classifying**

IV. Providing information related to restrictions

Donor restrictions impose responsibilities on management to ensure that an NFP uses donated resources in a manner specified by resource providers. Sometimes donor-imposed restrictions limit an NFP's ability to sell or exchange an asset (e.g., a donor gives a painting to a university subject to the requirement that it must be publicly displayed, properly maintained, and never sold). Information about restrictions is important in assessing an NFP's ability and limitations on its ability to allocate resources to provide services and pay lenders, suppliers, or employees. While NFPs report only one class of net assets with donor restrictions on the statement of financial position, they are required to provide relevant information about the nature and amounts of donor-imposed restrictions on net assets as discussed in the below.

Providing information about the nature and amounts of different types of donor-imposed restrictions

Under FASB ASC 958, NFPs provide information about the nature and amounts of different types of donor-imposed restrictions **either** by: (1) reporting their amounts on the face of the statement of financial position; **or** (2) including relevant details in the notes to the financial statements. Separate line items may be reported within net assets with donor restrictions or in notes to the financial statements to distinguish between various types of donor-imposed restrictions. For example, restrictions related to: (1) support of particular operating activities; (2) use in a specified future period; (3) the acquisition of long-lived assets; (4) investment for a specified term; (5) the creation of a donor-restricted endowment that is perpetual in nature; and (6) assets, like land or works of art, that are donated with stipulations that they be used for a specified purpose, be preserved, and not be sold.

The following illustration shows how an NFP might disclose the nature and amounts of donor restricted net assets under FASB ASC 958.

An illustrative disclosure of the nature and amounts of different types of donor-imposed restrictions

Note J.

NFP X's net assets with donor restrictions are subject to the following purpose or time restrictions.

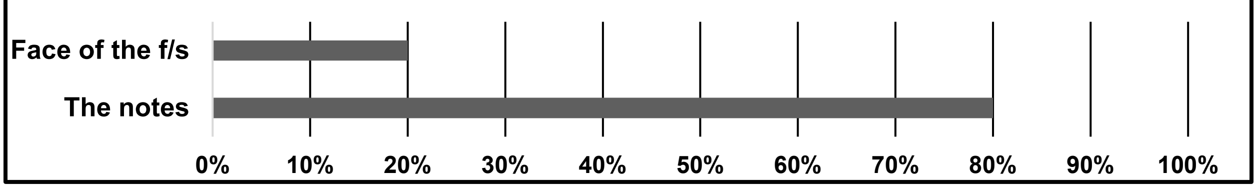
Subject to purpose restrictions:	
Program Omega	$ 15,200
Program Iota	10,000
Facilities and equipment	20,230
	45,430
Subject to time restrictions:	
For periods after September 30, 20X1	25,000
Not subject to appropriation or expenditure:	
Land required to be used as a recreational area in perpetuity	301,782
Total net assets with donor restrictions	$372,212

In looking at the above illustration, keep in mind that NFPs can provide information about the nature and amounts of different types of donor-imposed restrictions either by reporting their amounts on the face of the statement of financial position **or** including relevant details in the notes to the financial statements (as shown in the above illustration). Separate line items may be reported within net assets with donor restrictions or in notes to the financial statements to distinguish between various types of donor-imposed restrictions.

A. What are NFPs doing?

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course in terms of providing information about donor-imposed restrictions.

Are NFPs providing information about the nature and amounts of different donor restrictions on the face of the financial statements or the notes?



B. Exercise 2-6

Please answer the following question related to net assets.

What could have caused this?

The below excerpt from an NFP's audited statement of financial position reflects rather large deficit (i.e., the amounts are in thousands) in net assets without donor restrictions. What do you believe could have caused this to occur?

Net assets (deficit):		
Without donor restrictions	(42,596)	(27,311)
With donor restrictions	23,088	19,421
Total net assets (deficit)	(19,508)	(7,890)
Total liabilities and net assets (deficit)	$ 74,955	$ 72,558

V. Providing information related to designations

The FASB believes that information about self-imposed limits on an NFP's net assets (i.e., board-designated net assets) might be helpful to financial statement users.

Disclosures related to board-designated net assets

Board-designated net assets are net assets without donor restrictions that are subject to self-imposed limits by action of the governing board. Board-designated net assets may be earmarked for future programs, investment, contingencies, purchase or construction of fixed assets, or other uses. FASB ASC 958 requires that NFPs disclose information about the amounts and purposes of board-designated net assets either on the face of the statement of financial position or in the notes.

Note. FASB ASC 958 discusses that some governing boards may delegate designation decisions to internal management and that such designations are considered to be included in board-designated net assets. The following illustrations reflect two methods of how an NFP might present information about the amounts and purposes of board-designated net assets. The first illustration utilizes a tabular style presentation which could appear in either the notes or on the face of the statement of financial position. In taking this approach, it is important that the descriptions used be reasonably clear to financial statement users or contain an accompanying narrative description.

An illustration presenting information about the amounts and purposes of board-designated net assets

Net assets without donor restrictions:	
Undesignated	$ 70,000
Quasi-endowment	20,000
Operating reserve	5,000
Total net assets without donor restrictions	$ 95,000

The second illustration utilizes a more narrative type of disclosure about the amounts and purposes of board-designated net assets.

Another illustration presenting information about the amounts and purposes of board-designated net assets

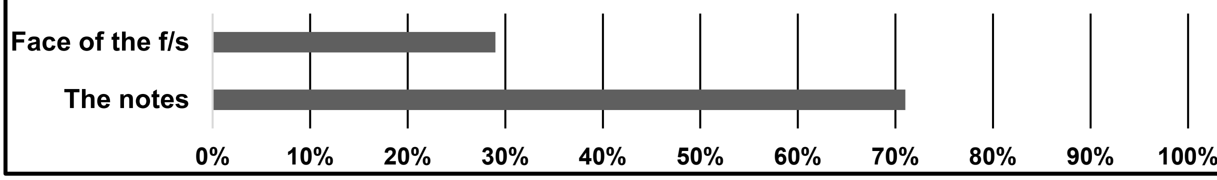
Note 10 - Net assets without donor restrictions

The Board of Directors of NFP C has standing board policies that impact the presentation of board-designated net assets. Bequests without donor restrictions are designated for long-term investment (quasi-endowment). The quasi-endowment balance at June 30, 20X1 was $20,000. The Board of Directors has also established an operating reserve with the objective of setting funds aside to be utilized in the event of financial adversity. The operating reserve balance at June 30, 20X1 was $5,000.

A. Choices NFPs are making

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course in terms of providing information about board-designated net assets.

Are NFPs emphasizing board-designated net assets on the face of the financial statements or in the notes?



B. What do you think about this presentation?

As illustrated in the following, NFPs should consider whether their presentation of board-designated net assets may confuse resource providers.

What do you think about this presentation?

The below excerpt from an NFP's audited statement of financial position reflects a deficit in undesignated net assets without donor restrictions.

Net Assets	
Without Donor Restrictions	
Undesignated	(428,648)
Board Designated	25,022,838
Net assets without donor restrictions	24,594,190
With Donor Restrictions	11,211,900
Total net assets	35,806,090

The course author is not a big fan of board-designations as they are internal decisions appearing in the financial statements which can always be reversed at the next board meeting. However, it is understandable that some boards like to designate amounts and to some degree it can give resource providers a sense of where an NFP intends to go and the need for resources. Having said all that, presenting designations for amounts greater than what the NFP has can potentially confuse resource providers who may question how an NFP designates amounts that they do not have. Therefore, the author would have suggested that the above NFP's board designate an amount to eliminate the deficit.

VI. Liquidity and availability disclosures

Earlier, we mentioned that NFPs are required to provide information regarding the entity's available resources and additional information useful in assessing its liquidity. The following chart discusses the two related areas of disclosure regarding liquidity and availability.

FASB ASC 958 contains two related areas of disclosure regarding liquidity and availability	
Liquidity	NFPs are required to provide qualitative information **in the notes** to financial statements that is useful in assessing an entity's liquidity and that communicates how an NFP manages its liquid resources available to meet cash needs for general expenditures within one year of the date of the statement of financial position.
Availability	NFPs are required to provide quantitative information **either on the face of the statement of financial position or in the notes**, and additional qualitative information **in the notes** as necessary, that communicates the availability of an NFP's financial assets at the date of the statement of financial position to meet cash needs for general expenditures within one year of the date of the statement of financial position. (**Note.** The availability of a financial asset may be affected by: its nature; external limits imposed by donors, laws, and contracts with others; and internal limits imposed by governing board decisions.)

A. Trends seen in the liquidity and availability disclosures

In developing this course, the author reviewed the same 100 audited financial statements to see the choices that NFPs are making in presenting the liquidity and availability disclosures. The following sections, illustrate two of the presentations the author found particularly interesting.

1. The "net" method

The "net" method

Financial assets available for general expenditure, that is, without donor or other restrictions limiting their use, within one year of the statement of financial position date, comprise the following:

	Amount
Cash and cash equivalents	$1,474,200
Promises to give without donor restrictions	146,023
Board-designated endowment distribution	189,000
Financial assets available for general expenditures in the next 12 months	$1,809,223

Our endowment funds consist of donor-restricted endowments and funds designated by the board as endowments. Income from donor-restricted endowments is restricted for specific purposes, with the exception of the amounts available for general use. Donor-restricted endowment funds are not available for general expenditure.

Our board-designated endowment of $4,725,009 is subject to an annual spending rate of four percent (beginning in 2019) as described in Note 17. Although we do not intend to spend from this board-designated endowment (other than amounts appropriated for general expenditures), these amounts could be made available if necessary.

We call the above illustration the “net” method as it just presents the net financial assets available for general expenditures (i.e., instead of reconciling the amounts from the statement of financial position to the amounts presented in the disclosure). Pros to this method include its brevity. Cons to this method include that some financial statements users may be confused that the disclosed amounts do not directly tie to amounts on the statement of financial position and question why.

2. The “reconciliation” method

We call the below illustration the “reconciliation” method as it directly reconciles amounts from the statement of financial position to the amount available for general expenditures within one year. Pros to this method include the clarity provided to financial statement users regardless of their NFP reporting background. Cons to this method include, to some degree, its length.

The “reconciliation” method

The following reflects the Theatre Group’s financial assets as of August 31, 2019, reduced by amounts not available for general use within one year of the statement of financial position date because of contractual or donor-imposed restrictions. Amounts not available include amounts set aside by donor restriction.

Financial assets at year-end:	2019
Cash and cash equivalents	$ 1,983,648
Grants, pledges, and other receivables	5,922,708
Investments	25,116,219
Total financial assets	$33,022,575
Less: amounts not available to be used within one year:	
Donor time restricted – grants, pledges and other	(3,188,572)
Donor restricted	(5,000,000)
Board designated net of approximate spending policy withdrawal	(23,521,468)
Financial assets available to meet general expenditures over the next twelve months	$ 1,312,535

The Theatre Group’s goal is to maintain financial assets to meet annual general operating expenses. General expenses average $2.0 million monthly depending on nature of programming activity which varies each year.

The Theatre’s board of directors have identified the investment account to be utilized to cover short-term and capital expenditures in negative cash flow periods. The funds are invested for long-term appreciation. This investment account is utilized to meet working capital needs, while continuing outreach to donors, foundations, corporations, and board of directors to meet needs. $23.5 million reduced as “board designated” is available for use at the discretion of the board.

VII. An illustrative statement of financial position

The following illustration shows a statement of financial position.

NFP X
Statements of Financial Position
September 30, 20X1 and 20X0

Assets:	**20X1**	**20X0**
Cash and cash equivalents	$ 33,500	$ 42,047
Accounts and interest receivable	22,600	37,800
Inventories and prepaid expenses	5,047	7,058
Contributions receivable	52,740	44,321
Short-term investments	78,235	65,035
Land, buildings, and equipment	236,785	205,786
Long-term investments	356,458	378,256
Total assets	$785,365	$780,303
Liabilities and net assets:		
Accounts payable	29,053	15,089
Refundable advance		1,520
Grants payable	27,250	20,784
Notes payable	12,030	17,235
Long-term debt	82,035	87,568
Total liabilities	150,368	142,196
Net Assets:		
Without donor restrictions:		
Undesignated	157,671	144,800
Board designated quasi-endowment	105,114	102,434
Total without donor restrictions	262,785	247,234
With donor restrictions	372,212	390,873
Total net assets	634,997	638,107
Total liabilities and net assets	$785,365	$780,303

VIII. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

A. Suggested solution to Exercise 2-1

		True or False
1	If an NFP only had net assets without donor restrictions, on the face of its statement of financial position, it must show a line item "Total net assets with donor restrictions" and a dash or zero for the amount.	**False.** FASB ASC 958 requires that a statement of financial position report all of the following **amounts**: (a) total assets; (b) total liabilities; (c) total net assets; (d) total net assets with donor restrictions; and (e) total net assets without donor restrictions. If an NFP **did not have any amounts** of net assets with donor restrictions, that heading would not need to be presented. However, an NFP could certainly include the line item "Total net assets with donor restrictions" and a dash or zero for the amount or disclose the fact that no net assets with donor restrictions were present at year-end to answer potential questions from resource providers.

B. Suggested solution to Exercise 2-2

		True or False
1	The majority of NFPs utilize the left-to-right format for the statement of financial position.	**False.** In the audited financial statements of 100 NFPs that the author reviewed for the course, 10% of NFPs used the left-to-right format and 90% used the top-to-bottom format.

C. Suggested solution to Exercise 2-3

How will an NFP know the right level?

How can an NFP ensure that its statement of financial position provides the right level of detail?

Well, it comes back to looking at the NFP and its resource providers and the level of detail they desire. For example, a contribution-based NFP may want to look closely at its smaller trial balance numbers (e.g., asset categories representing less than 1% of total assets) and combining those items into an "other" category or perhaps providing details to line items in the notes (e.g., the property and equipment example we looked at earlier). While there are certainly some line items like "cash and cash equivalents" that users typically expect to see, some line items can be combined into an "other" category. This is particularly true for contribution-based NFPs as their resource providers are likely more interested in the statement of activities and statement of functional expenses (or its disclosure) and the quicker the NFP can get them to those statements the better.

D. Suggested solution to Exercise 2-4

		True or False
1	NFP business-oriented health care entities are required to present a classified balance sheet.	**True.** FASB ASC 954-210-45-1 requires this for NFP business-oriented health care entities.
2	On its statement of financial position NFP Z wants to classify its assets as current and noncurrent. However, instead of classifying its liabilities as current and noncurrent, NFP Z wants to sequence its liabilities according to the nearness of their maturity and resulting use of cash. This is a good idea.	**False.** When FASB ASC 958 discusses the methods allowed to provide information about liquidity one of the methods is classifying assets **and** liabilities as current and noncurrent. The idea of only classifying assets and putting liabilities in order of maturity (i.e., creating a new hybrid liquidity method) would create a confusing presentation for financial statement users.

E. Suggested solution to Exercise 2-5

To classify or not classify… NFP Z is not a business-oriented health care entity. NFP Z is trying to weigh some of the pros and cons to presenting a classified statement of financial position. Please complete the below to assist NFP Z in making its decision.	
Pros to classifying	**Cons to classifying**
• Assists in looking at an NFP's assets and liabilities from a working capital (i.e., current assets versus current liabilities) perspective; and • Some resource providers (e.g., banks) are going to perform a working capital calculation and classifying the assets and liabilities on the statement may take some guesswork out of that calculation	• To some degree you are doubling the lines on the statement for items like current and noncurrent contributions receivable which to some degree can clutter the presentation of the statement; • For some items, the classification of current or noncurrent is either difficult or not meaningful (e.g., certain investments may be classified as noncurrent but could potentially be liquidated rather quickly to satisfy a current liability); and • Takes more time to prepare and some resource providers may not be interested in the information

F. Suggested solution to Exercise 2-6

What could have caused this?

The below excerpt from an NFP's audited statement of financial position reflects a rather large deficit (i.e., the amounts are in thousands) in net assets without donor restrictions. What do you believe could have caused this to occur?

Net assets (deficit):		
Without donor restrictions	(42,596)	(27,311)
With donor restrictions	23,088	19,421
Total net assets (deficit)	(19,508)	(7,890)
Total liabilities and net assets (deficit)	$ 74,955	$ 72,558

In the case of this NFP, the reason for the deficit becomes apparent in looking at the remainder of the statement of financial position. It lies with a large accrued pension obligation. **Note.** In this particular case, the NFP and its auditor did not specifically expound on the large deficit as they felt it was understandable in looking at the overall financial statements. NFPs with deficits in net assets will want to make sure users can understand the reason for such deficits if they exist.

ASSETS		
Cash and cash equivalents	$ 3,869	$ 4,338
Sponsorships and other receivables - net	10,086	8,373
Inventory and other assets	2,065	2,117
Investments	47,079	46,527
Assets held in trust by others	11,508	10,569
Furniture and equipment - net	348	634
Total assets	$ 74,955	$ 72,558
LIABILITIES AND NET ASSETS		
Accounts payable and accrued expenses	$ 7,040	$ 8,197
Grants and awards payable	2,561	4,114
Refundable advances and deferred revenue	5,113	2,349
Accrued pension obligation	79,749	65,788
Total liabilities	94,463	80,448

The Statement of Activities

The Statement of Activities

Learning Objectives

Upon completing this chapter, you will be able to:

- Perceive key issues related to the statement of activities; and
- Understand how the statement of activities can be tailored to fit the NFP and meet the needs of resource providers.

I. The statement of activities

The statement of activities for an NFP is the financial statement that an NFP issues in lieu of a business entity's income statement. As illustrated below, the information provided in the statement of activities is instrumental in trying to understand an NFP and its activities.

What did the NFP achieve?

The statement of activities (and its accompanying notes) is a period of time measurement where the NFP looks back and financially describes what it did in terms of fulfilling its mission. Resource providers can utilize the statement and accompanying notes to assess: (1) the NFP's performance during a period; (2) the NFP's service efforts and its ability to continue to provide services; and (3) how an NFP's managers have discharged their stewardship responsibilities and other aspects of their performance. The statement of activities presents a unique branding opportunity for NFPs. NFPs have options in terms of the information they provide to resource providers in describing the progress they made in fulfilling their mission with the resources they were provided.

A. Naming options

In presenting their period of time measurement of mission fulfillment, most NFPs use the title **statement of activities**. However, some NFPs use alternative titles (e.g., **statement of changes in net assets**, **statement of operations and changes in net assets**, etc.). In the audited financial statements of 100 NFPs that the author reviewed for the course, 93% of NFPs used the **statement of activities** title and 7% used alternative titles.

II. Key concepts related to the statement of activities

In this section of the course, we want to explore some basic key concepts related to the statement of activities. While the primary focus of a business entity's income statement is the entity's net income or bottom line, the primary focus of an NFP's statement of activities is how the NFP's activities related to mission fulfillment. FASB ASC 958 provides unique guidance, options and requirements for how NFPs present the statement of activities.

A. The statement of activities shall report…

Instead of reporting net income, NFPs report the change in net assets. As seen in the following chart, NFPs report the change in net assets for each of the net asset categories that we saw in chapter 2.

The statement of activities focuses on the NFP as a whole and reports all of the following amounts for the period:

The Statement of Activities

- **The change in net assets without donor restrictions**
- **The change in net assets with donor restrictions**
- **The change in total net assets**

1. Exercise 3-1

Please answer the following true or false question.

		True or False
1	FASB ASC 958 requires the change in net assets to articulate to the net assets or equity reported in the statement of financial position.	

B. Flexibility in formatting

FASB ASC 958-205-55-11 suggests four ways that items could be sequenced in the statement of activities: (1) revenues and gains first, then expenses, then losses, reclassification of net assets, which must be shown separately, is reported with revenues and gains; (2) revenues, expenses, gains and losses, and reclassification of net assets shown last; (3) certain revenues, less directly related expenses, followed by a subtotal, then other revenues, other expenses, gains and losses, and reclassification of net assets; and (4) expenses followed by revenues, gains and losses, and the reclassification of net assets. Those items could be arranged in other ways, and other subtotals may be included. The sequencing of the statement of activities is an area where NFPs can look at their financial statement users and determine the sequence which best communicates the NFP's progress towards its mission.

1. The single-column versus the multi-column format

In addition to the sequencing of line items on the statement of activities, another area of formatting flexibility relates to the number of columns presented on the statement.

The single-column versus the multi-column format	
	The **single-column format** (a.k.a., the pancake or stacked format) uses one column to present each year's changes in net assets. The change in net assets without donor restrictions is typically presented first on the statement, followed by the change in net assets with donor restrictions, and finally the change in total net assets (i.e., the presentation stacks the levels of net assets). The single-column format provides for a more straightforward presentation of multi-year comparative information than the multi-column format does.
	The **multi-column format** (a.k.a., the columnar format) presents the change in net assets without donor restrictions and the change in net assets with donor restrictions as separate columns. The multi-column format provides for a more straightforward presentation of the effects of net asset reclassifications and allows for the display of entity-wide totals for line items (e.g., it allows for total contribution revenue to be displayed in an additional column). Sometimes, NFPs will also add a total only column with prior year information or perhaps present a full prior year statement on a separate page.

If only one page is used and comparative financial statements are presented, the multi-column format can result in information overload to the reader

	Without donor restrictions	With donor restrictions	Total	Without donor restrictions	With donor restrictions	Total
Revenues, gains, and other support:						
Contributions and grants	$ 3,414,183	11,312,836	14,727,019	3,583,615	15,621,924	19,205,539
Memberships	2,831,092	–	2,831,092	3,352,308		3,352,308
In-kind contributions *(note 15)*	8,426	–	8,426	87,815	–	87,815
Financial support received from volunteer groups	134,825	–	134,825	148,048	–	148,048
Admissions	670,992	–	670,992	1,437,488	–	1,437,488
Museum store sales	396,755	–	396,755	1,035,268	–	1,035,268
Rental income	357,770	–	357,770	1,042,921	–	1,042,921
Tuition and fees	34,642	–	34,642	234,946	–	234,946
Total investment return *(note 6)*	2,022,458	12,160,211	14,182,669	212,026	1,769,934	1,981,960
Other revenues and gains *(note 16)*	2,179,827	–	2,179,827	1,309,901	7,700	1,317,601
Total revenues and gains	12,050,970	23,473,047	35,524,017	12,444,336	17,399,558	29,843,894
Net assets released from restrictions *(note 13)*	5,613,183	(5,613,183)	–	9,930,739	(9,930,739)	–
Total revenues, gains, and other support	17,664,153	17,859,864	35,524,017	22,375,075	7,468,819	29,843,894
Expenses *(note 17)*:						
Program activities:						
Acquisition of art *(note 9)*	164,749	–	164,749	387,325	–	387,325
Museum programs	10,189,377	–	10,189,377	16,418,870	–	16,418,870
Film center programs	1,049,159	–	1,049,159	1,706,098	–	1,706,098
Total program activities	11,403,285	–	11,403,285	18,512,293	–	18,512,293
Supporting activities:						
Management and general	2,027,990	–	2,027,990	2,709,556	–	2,709,556
Fundraising, membership, and development	2,378,712	–	2,378,712	2,619,310	–	2,619,310
Total supporting activities	4,406,702	–	4,406,702	5,328,866	–	5,328,866
Total expenses	15,809,987	–	15,809,987	23,841,159	–	23,841,159
Increase (decrease) in net assets	1,854,166	17,859,864	19,714,030	(1,466,084)	7,468,819	6,002,735
Net assets at beginning of year, as restated *(note 2)*	62,137,265	83,072,772	145,210,037	63,603,349	75,603,953	139,207,302
Net assets at end of year	$ 63,991,431	100,932,636	164,924,067	62,137,265	83,072,772	145,210,037

2. Exercise 3-2

Please answer the following true or false question.

		True or False
1	The single-column format is generally seen less frequently than the multi-column format.	

3. An example of incorporating boldness into the statement of activities

As we saw earlier, one of the suggested sequencing options for the statement of activities in FASB ASC 958-205-55-11 involves presenting expenses followed by revenues, gains and losses, and the reclassification of net assets. However, this option is seldom seen in practice. When utilized, this approach can create a dramatic effect.

The following NFP presented expenses first on the statement of activities as it wanted to emphasize mission-related expenses to resource providers

	Without Donor Restrictions	With Donor Restrictions	Total
Our mission program and mission support expenses were:			
Mission program services:			
Patient support	$ 221,219	$ -	$ 221,219
Research	97,713		97,713
Prevention	67,396	-	67,396
Detection/treatment	56,171	-	56,171
Total mission program services	442,499	-	442,499
Mission support services:			
Management and general	35,551	-	35,551
Fund-raising	104,198	-	104,198
Total mission support services	139,749	-	139,749
Total mission program and mission support services expenses	582,248	-	- 582,248
Our mission program and mission support expenses were funded by:			
Support from the public:			
Special events	97,596	39,068	136,664
Contributions	148,554	84,602	233,156
Bequests	97,092	40,243	137,334
Contributed services, merchandise and other in-kind contributions	15,192	24,904	40,096
Other	12,066	479	12,545
Total support from the public	370,500	189,296	559,796
Investment income	46,823	21,051	67,874
Change in value of split-interest agreements	3,061	15,892	18,953
Grants and contracts from government agencies	5,436	355	5,791
Other (losses) gains	745	(345)	399
Total revenues, gains and other support	426,565	226,249	652,813
Use of amounts restricted by donors for specified purpose or time	190,108	(190,108)	-
Change in net assets prior to impact of retirement plan liability	34,425	36,141	70,566
Net increase in retirement plan liability	1,287	-	1,287
Change in net assets	33,138	36,141	69,279
Net assets, beginning of period	473,835	684,921	1,158,756
Net assets, end of period	$ 506,973	$ 721,062	$ 1,228,035

C. Classifying and aggregating revenues, expenses, gains, and losses

Information about revenues, expenses, gains, losses, and reclassification of net assets generally is provided by aggregating items that possess similar characteristics into reasonably homogeneous groups.

Which net asset classification does this belong with?	
Revenues	The statement of activities reports revenues as increases in net assets without donor restrictions unless the use of the assets received is limited by donor-imposed restrictions.
Expenses	The statement of activities reports expenses as decreases in net assets without donor restrictions, with the exception of investment expenses, which are netted against investment return and reported in the net asset category in which the net investment return is reported.
Gains and Losses	The statement of activities reports gains and losses recognized on investments and other assets (or liabilities) as increases or decreases in net assets without donor restrictions unless their use is restricted by explicit donor stipulations or by law that extends donor restrictions.

1. Striking the right level of detail in the line items shown on the statement of activities

NFPs should consider the level of detail that they are presenting within the statement of activities and the notes. Virtually all NFPs would find it excessively difficult and expensive to provide full information about every detail of their activities during a reporting period. Even if that were possible, the resulting masses of data would be very difficult for resource providers to understand and use. Consequently, preparing financial statements for all but the simplest and smallest entities requires simplifying, condensing, and aggregating data into meaningful line items, subtotals, and totals.

The following NFP allocated a great amount of space to revenues and little space to expenses

Change in net assets without donor restrictions		
Support and revenue		
Animal control services	$ 13,330	$ 10,008
Adoption fees, net of discounts	329,760	337,225
Behavior fees	53,299	67,551
Boarding income, net of discounts	217,204	180,524
Contract income	3,281,460	3,168,310
Contributions and bequests	5,504,922	7,622,497
Gains on sale of fixed assets	43,866	4,697
Gifts-in-kind	149,750	145,542
Helping paws income, net of discounts	12,932	12,974
Humane education	38,379	40,648
Impound fees	8,639	8,001
Interest and dividends	381,970	302,852
Kids club	11,599	-
License fees	451,613	482,417
Outreach events	3,509	-
Rental income	160,970	161,999
Scout Sundays	630	-
Service fees, net of discounts	143,424	127,253
Special events - golf	227,196	242,648
Special events - Wiggle Waggle Walk	220,861	233,361
Store sales, net of discounts and cost of goods sold	130,327	137,996
Volunteer income	570	6,260
Wellness clinic, net of discounts	368,276	452,212
Gain on sale of investments	269,350	210,760
Unrealized gains (losses) on investments	1,990,954	(752,444)
Net assets released from restrictions	245,274	469,437
Total support and revenue without donor restrictions	14,260,064	13,672,728
Expenses		
Program	9,876,112	9,343,637
Management and general	1,922,578	1,435,603
Fundraising	1,432,630	1,328,064
Total expenses	13,231,320	12,107,303
Change in net assets without donor restrictions	1,028,744	1,565,425

2. Exercise 3-3

Please answer the following question related to the statement of activities.

How could we improve this?
We just reviewed an excerpt from an NFP's statement of activities. If the NFP asked you how it could improve its presentation, what would you suggest?

3. An example of providing program related details on the statement of activities

As illustrated in the following, in order to provide information to resource providers, NFPs may want to consider breaking down program expenses into multiple categories on the statement of activities or the notes (if natural expense information is presented on the face of the statement of activities).

This NFP broke down its program expenses into six categories on the statement of activities

Expenses and losses:	
Programs services:	
Instructional and academic	104,519
Curatorial, libraries, and collections	43,082
Special exhibitions	5,269
Museum education	4,103
Other programs	6,457
Auxiliary activities	15,092
Managerial and general:	
General administration	31,810
Interest and debt cost amortization	7,339
Fundraising and member development	14,393
Total expenses and losses	232,064

4. Exercise 3-4

Please answer the following true or false question.

		True or False
1	NFPs are required to present functional expense information either on the face of the statement of activities or in the notes. NFPs have program services and supporting activities (e.g., management and general, fundraising, etc.). When presenting information about program services, the majority of NFPs present only one program services category.	

D. Unique items appearing on the statement of activities

As we stated earlier, the statement of activities is the financial statement that an NFP issues in lieu of a business entity's income statement. However, as we have already seen, there certainly are some differences. In this section, we will briefly discuss some of the unique items (contributions; reclassification of net assets; functional versus natural expenses; special events; and changes in net assets) which may appear on an NFP's statement of activities and some of the key accounting requirements related to them.

1. Contributions

For many NFP's contributions represent an essential funding source. However, for other NFP's contributions may not necessarily be an essential funding source.

	Are contributions revenues or gains? The classification of contributions received as revenues or gains depends on whether the transactions are part of the NFP's ongoing major or central activities (revenues) or are peripheral or incidental to the NFP (gains). For example, the Field Museum of Natural History in Chicago reports contributions as revenues due to their significance. However, a large NFP business-oriented health care entity like Baylor Health Care System in Texas reports contributions as gains as the amounts are not as significant.

The statement of activities also needs to indicate whether contributions received are restricted by donor stipulations or are without restriction.

Indicating the presence or absence of donor-imposed restrictions on contributions	
	In the absence of a donor's explicit stipulation or circumstances surrounding the receipt of a contribution that make clear the donor's implicit restriction on use, contributions are reported as revenues or gains without donor restrictions, which increase net assets without donor restrictions.
	Donor-restricted contributions are reported as restricted revenues or gains (donor-restricted support), which increase net assets with donor restrictions.
	However, donor-restricted contributions whose restrictions are met in the same reporting period may be reported as support in net assets without donor restrictions, provided that an NFP has a similar policy for reporting investment gains and income, reports consistently from period to period, and discloses its accounting policy.
	ASU No. 2018-08 allows NFPs to elect the simultaneous release policy (described in the above box) for donor-restricted contributions that were **initially conditional contributions** independent of any election for other donor-restricted contributions. The NFP would need to report consistently from period to period and disclose its accounting policy.

Under ASU No. 2020-07, *Presentation and Disclosures by Not-for-Profit Entities for Contributed Nonfinancial Assets*, NFPs have additional presentation and disclosure requirements related to contributed nonfinancial assets (e.g., fixed assets, land, buildings, the use of assets, food, clothing, pharmaceuticals, services, etc.). NFPs are required to present contributed nonfinancial assets as a separate line item in the statement of activities apart from contributions of cash or other financial assets. NFPs also have additional disclosure requirements by category of nonfinancial asset.

2. Reclassification of net assets

As discussed earlier, net assets are classified based on the presence or absence of donor-imposed restrictions. When a donor-imposed restriction is satisfied (or in rare cases a restriction is imposed on previously net assets without donor restrictions) a reclassification of net assets is reported in the statement of activities. The term **reclassification of net assets** refers to the simultaneous increase of one class of net assets and decrease of another. A reclassification of net assets usually results from a donor-imposed restriction (donors include other types of contributors, including makers of certain grants) being satisfied or otherwise lapsing. Reclassification of net assets, such as expirations of donor-imposed restrictions, are required to be reported as separate items.

Reclassifications of net assets are required if any of the following hurdles are cleared or added:	
	The NFP fulfills the purposes for which the net assets were restricted.
	Donor-imposed restrictions expire with the passage of time or with the death of a split-interest agreement beneficiary (if the net assets are not otherwise restricted).
	A donor withdraws, or court action removes, previously imposed restrictions.
	A donor imposes restrictions on net assets without donor restrictions. For example, a donor may make a restricted contribution that is conditioned on the NFP restricting a stated amount of its net assets without donor restrictions. Such restrictions that are not reversible without donors' consent result in a reclassification of net assets without donor restrictions to net assets with donor restrictions.

3. Exercise 3-5

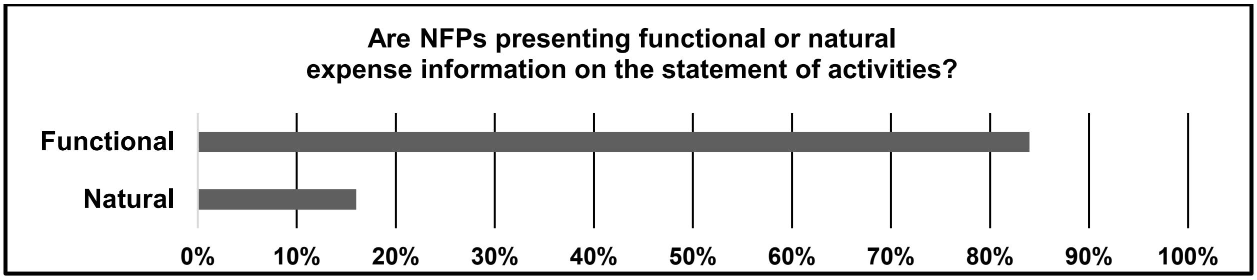
Please answer the following true or false question.

		True or False
1	Unless donor stipulations limit the use of the assets for a period of time or for a particular purpose, donor restrictions on long-lived assets, if any, or cash to acquire or construct long-lived assets are considered to have expired when the assets are placed in service.	

4. Functional versus natural expenses

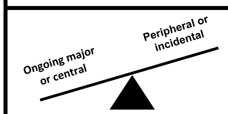
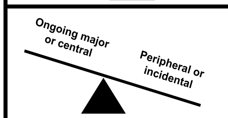
In fulfilling its mission, an NFP obtains and uses resources to provide certain types of goods or services to its members or society. The nature of those goods or services or the identity of the groups or individuals that receive them is often critical in donors' or other resource providers' decisions to contribute or otherwise provide resources to an NFP. Presenting expenses by **functional classification** (i.e., the grouping of expenses according to the purpose for which costs are incurred like program, management and general, and fundraising) provides more useful information regarding mission fulfillment than presenting expenses by **natural classification** (i.e., the grouping of expenses according to the kinds of economic benefits received in incurring those expenses like salaries and wages, utilities, and depreciation). Therefore, NFPs are required to present functional expense information **either** on the face of the statement of activities **or** in the notes. NFPs which choose to present functional expense information in the notes present natural expense information on the face of the statement of activities.

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course.



5. Special events

NFPs may hold special events (e.g., a dinner) and such events can be ongoing and major activities. However, as discussed in the following chart, this is not always the case.

The presentation of special events depends on the nature of the special event as provided below:	
	Special events can be ongoing and major activities; if so, an NFP will report the gross revenues and expenses of those activities.
	An NFP may report net amounts for its special events if they result from peripheral or incidental transactions. Costs netted against receipts from peripheral or incidental special events are limited to direct costs.

As discussed above, special events can be ongoing and major activities. In such situations, an NFP will report the gross revenues and expenses of those activities. FASB ASC 958 provides three possible methods to display a special event that is an ongoing and major activity in the statement of activities. So, let's look at three possible methods to display a special event that is an ongoing and major activity based off that guidance. To begin, let's use the facts described in the following chart that are common to each of the three illustrations.

NFP J has a special event that is an ongoing and major activity with ticket revenue of $20,000.
The event includes a dinner that costs NFP J $5,000 and that has a fair value of $7,000.
In addition to the direct benefits to donors (i.e., the $5,000 in meals and facilities rental), NFP J incurred other direct costs of $4,000 in connection with promoting and conducting the event. These costs should be reported as fundraising.

NFP J also has the following transactions, which are unrelated to the special event:

- Contributions without donor restrictions of $50,000
- Program expenses of $35,000
- Management and general expenses of $15,000
- Fundraising expenses of $10,000

In the first illustration of how the special event could be displayed, NFP J uses an approach where the direct benefits to donors are displayed on a line below gross revenue from the special event as shown in the following:

Changes in net assets without donor restrictions:		
Contributions		$50,000
Special event revenue	20,000	
Less: Costs of direct benefits to donors	(5,000)	
Net revenues from special events		15,000
Contributions and net revenues from special events		65,000
Other expenses:		
Program		35,000
Management and general		15,000
Fundraising		14,000
Total other expenses		64,000
Increase in net assets without donor restrictions		$ 1,000

In the second illustration of how the special event could be displayed, NFP J uses an approach where the gross revenue from the special event is bifurcated between part exchange (for the fair value the participant received) and part contribution (for the excess of the payment over that fair value), as shown in the following:

Changes in net assets without donor restrictions:		
Contributions		$63,000
Dinner sales	7,000	
Less: Costs of direct benefits to donors	(5,000)	
Gross profit on special events		2,000
Contributions and net revenues from special events		65,000
Other expenses:		
Program		35,000
Management and general		15,000
Fundraising		14,000
Total other expenses		64,000
Increase in net assets without donor restrictions		$ 1,000

In the third illustration of how the special event could be displayed, NFP J uses an approach where the costs of direct benefits to donors are displayed in the same section of the statement of activities as are other programs or supporting services, as shown on the following page.

Changes in net assets without donor restrictions:	
Revenues:	
Contributions	$50,000
Special event revenue	20,000
Total revenues	70,000
Expenses:	
Program	35,000
Costs of direct benefits to donors	5,000
Management and general	15,000
Fundraising	14,000
Total other expenses	69,000
Increase in net assets without donor restrictions	$ 1,000

The author observed the following in one of the 100 audited NFP financial statements reviewed for the course in presenting a special event.

The following excerpt (from one of the 100 audited NFP f/s reviewed for the course) followed the presentation suggested in the first illustration of how a special event could be displayed

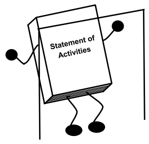
	Without donor restrictions	With donor restrictionss	Total
Contribution revenue			
Corporate	$ 7,260,448	$ 1,790,740	$ 9,051,188
Foundation	2,532,676	5,979,907	8,512,583
Individual	7,829,440	13,206,201	21,035,641
Government	1,621,027	917,020	2,538,047
Special Events	1,155,107	-	1,155,107
Less: costs of direct benefit to donors	(282,415)	-	(282,415)
Donated services and materials	4,429,447	-	4,429,447
	$ 24,545,730	$ 21,893,868	$ 46,439,598

6. Changes in net assets

As we have alluded to already, NFPs have operating purposes other than to provide goods or services at a profit, and resource providers do not focus primarily on profit as an indicator of an NFP's performance. Therefore, the combination of revenues, expenses, gains, and losses often is referred to as a change in net assets. The statement of activities will report the change in net assets for each of the two net asset categories (i.e., without and with donor restrictions) and the change in total net assets.

III. Possibly including a measure of operations

Another area of flexibility NFPs have when preparing the statement of activities is the incorporation of a measure of operations into the statement. Some NFPs prefer to include a measure of operations within their statement of activities. For example, the operating/nonoperating format is frequently seen in the college and university sector.



Financial statement flexibility

Classifying revenues, expenses, gains, and losses within classes of net assets does not prevent incorporating additional classifications within a statement of activities. For example, within a class or classes of changes in net assets, an NFP may classify items as: (1) operating and nonoperating; (2) expendable and nonexpendable; (3) recurring and nonrecurring; and (4) in other ways.

Some limitations on an NFP's use of an intermediate measure of operations are imposed by certain sections of the FASB ASC. If a subtotal such as income from operations is presented, it is required to include: [1] an impairment loss recognized for a long-lived asset (asset group) to be held and used, pursuant to FASB ASC 360; [2] costs associated with an exit or disposal activity that does not involve a discontinued operation, pursuant to FASB ASC 420; [3] a gain or loss recognized on the sale of a long-lived asset (disposal group) that is not a component of an entity that qualifies for discontinued operations treatment, pursuant to FASB ASC 360.

	A few key requirements related to including a measure of operations
	Since terms such as operating income, operating profit, operating surplus, operating deficit, and results of operations are used with different meanings, if an intermediate measure of operations (e.g., excess or deficit of operating revenues over expenses) is reported, it is required to be in a financial statement that, at a minimum, reports the change in net assets without donor restrictions for the period.
	If an NFP's use of the term **operations** is not apparent from the details provided on the face of the statement, a note to the financial statements is required to describe the nature of the reported measure of operations or the items excluded from operations.
	Providing a measure of operations in a statement of activities may include internal board designations, appropriations, and similar actions affecting that measure. If an NFP presents internal board designations, appropriations, and similar actions on the face of the financial statements, a note to financial statements should provide an appropriate disaggregation and description by type of these actions if not provided on the face of the financial statements.

Incorporating a measure of operations into the statement of activities allows the statement to reflect how the NFP talks about its results internally. NFPs have wide discretion in how they define their operating and nonoperating activities. Two of the more frequently seen nonoperating activities are: (1) investment gains or income in excess of the NFP's spending policy [i.e., either you have a spending rate or some budgeted amount of investment return and the difference between that number and the actual return is presented as nonoperating]; and (2) certain items related to capital assets [e.g., contributions restricted for the acquisition of long-lived assets].

A. Exercise 3-6

Please answer the following question related to presenting an operating measure.

Are you good with this?
NFP X is considering presenting depreciation expense as nonoperating. Do you have any advice to them regarding this?

B. If presenting a measure of operations consider the complexity being added

As illustrated in the following, if an NFP presents a measure of operations, they should consider the level of complexity that they are adding to the statement of activities.

The following excerpt shows the nonoperating categories used by one NFP. While this may be helpful, some users may be confused by the level of categories of nonoperating activities

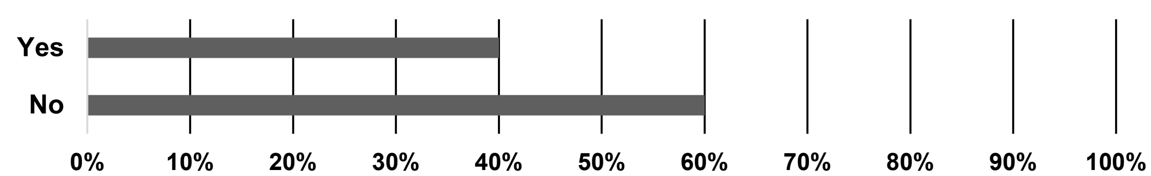
NON-OPERATING

- Museum-designated and donor-restricted gifts . . . .
- Endowment gifts (includes board-designated endowment) . . . .
- Endowment support for current activities (Note G) . . . .
- Investment return in excess of current support (Note G). . . . .
- Change in value of split interest agreements (Note H) . . . .
- Depreciation and non-capitalized expenditures (Notes E and F) . . . .
- Interest expense on bonds and interest rate swaps (Notes A and K) . . . .
- Realized and change in unrealized gains on 2015 bond proceeds. . . . .
- Transfer of designated non-operating funds to operating and other. . . . .
- Net assets released from donor restrictions . . . .
- Change in net assets before collection items not capitalized and other adjustments
- Purchases of art (Note D) . . . .
- Proceeds from sales of art . . . .
- Net assets released from donor restrictions to fund acquisitions of art . . . .
- Pension-related changes other than NPPC (Note I) . . . .
- Change in fair value of interest rate exchange agreements (Notes G and K). . . .

C. Choices NFPs are making

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course in terms of NFPs including a measure of operations in the statement of activities.

Are NFPs including a measure of operations in the statement of activities?



IV. Illustrations of the statement of activities

As we discussed earlier, NFPs have flexibility when it comes to the format of the statement of activities. In this section, we want to illustrate a couple of popular formats starting with the multi-column format (a.k.a., the columnar approach). The following statement of activities utilizes the multi-column format. Sometimes, NFPs will also add a total only column with prior year information or perhaps present a full prior year statement on a separate page.

NFP D
Statement of Activities
Year Ended September 30, 20X1

	Without Donor Restrictions	With Donor Restrictions	Total
Revenues, gains, and other support:			
Contributions of cash and other financial assets	$103,211	$38,000	$141,211
Contributions of nonfinancial assets	42,157	18,776	60,933
Fees	4,546		4,546
Investment return, net	63,181	63,670	126,851
Other	2,026		2,026
Net assets released from restrictions:			
Satisfaction of program restrictions	31,058	(31,058)	
Expiration of time restrictions	15,012	(15,012)	
Total revenues, gains, and other support	261,191	74,376	335,567
Expenses:			
Program Omega	97,068		97,068
Program Iota	83,012		83,012
Management and general	35,013		35,013
Fundraising	27,884		27,884
Total expenses	242,977		242,977
Change in net assets	18,214	74,376	92,590
Net assets at beginning of year	200,417	300,773	501,190
Net assets at end of year	$218,631	$375,149	$593,780

The next statement of activities format that we want to look at is the single-column or pancake approach (as the presentation stacks the levels of net assets). The following page contains an illustrative statement of activities for a different NFP which reports information in a single column.

NFP E
Statement of Activities
Year Ended June 30, 20X1

Changes in net assets without donor restrictions:	
Revenues and gains:	
Contributions of cash and other financial assets	$102,396
Contributions of nonfinancial assets	20,972
Fees	7,456
Investment return, net	43,126
Other	2,021
Total revenues and gains without donor restrictions	$175,971
Net assets released from restrictions:	
Satisfaction of program restrictions	25,078
Expiration of time restrictions	52,012
Total net assets released from restrictions	77,090
Total revenues, gains, and other support without donor restrictions	253,061
Expenses:	
Program	147,019
Management and general	54,843
Fundraising	39,874
Total expenses	241,736
Increase in net assets without donor restrictions	11,325
Changes in net assets with donor restrictions:	
Contributions of cash and other financial assets	55,767
Investment return, net	41,675
Net assets released from restrictions	(77,090)
Increase in net assets with donor restrictions	20,352
Increase in total net assets	31,677
Net assets at beginning of year	304,192
Net assets at end of year	$335,869

V. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

A. Suggested solution to Exercise 3-1

		True or False
1	FASB ASC 958 requires the change in net assets to articulate to the net assets or equity reported in the statement of financial position.	**True.** It also requires the change in net assets to be referred to with a descriptive term such as change in net assets or change in equity.

B. Suggested solution to Exercise 3-2

		True or False
1	The single-column format is generally seen less frequently than the multi-column format.	**True.** In the audited financial statements of 100 NFPs that the author reviewed for the course, 24% of NFPs used the single-column format and 76% used the multi-column format.

C. Suggested solution to Exercise 3-3

How could we improve this?

We just reviewed an excerpt from an NFP's statement of activities. If the NFP asked you how it could improve its presentation, what would you suggest?

While this NFP received significant amounts of resources from investment income and fees, contributions were also a very meaningful resource for its operations. Based on this, the author would first suggest that the NFP increase the amount of information given to potential donors regarding the programs the NFP provides (e.g., by breaking out **program expenses** into more than one category). To make the statement easier to read and increase the focus on expenses, the author would also suggest that the NFP reduce the line items in revenues (i.e., the NFP devoted over 15-line items to revenue streams which individually made up less than 2% of support and revenue). If the NFP believed its resource providers needed extreme detail regarding its revenue streams, it could still improve the allocation of space on the statement by consolidating some line items and/or creating an "other revenue" type category and explaining the detail in the footnotes.

D. Suggested solution to Exercise 3-4

		True or False
1	NFPs are required to present functional expense information either on the face of the statement of activities or in the notes. NFPs have program services and supporting activities (e.g., management and general, fundraising, etc.). When presenting information about program services, the majority of NFPs present only one program services category.	**False.** NFPs have discretion in defining their major programs and for some entities a single program services category may be adequate. However, most NFP's break program services down into multiple categories to provide resource providers with meaningful information regarding the NFP's service efforts. In the audited financial statements of 100 NFPs that the author reviewed for the course, 28% of NFPs used a single program services category and 72% used multiple program services categories.

E. Suggested solution to Exercise 3-5

		True or False
1	Unless donor stipulations limit the use of the assets for a period of time or for a particular purpose, donor restrictions on long-lived assets, if any, or cash to acquire or construct long-lived assets are considered to have expired when the assets are placed in service.	**True.** This is specified in FASB ASC 958-205-45-12.

F. Suggested solution to Exercise 3-6

Are you good with this?

NFP X is considering presenting depreciation expense as nonoperating. Do you have any advice to them regarding this?

NFPs should definitely put thought into what they classify as nonoperating. For example, if an NFP presents depreciation expense as nonoperating, this can cause problems if the NFP presents functional expense information on the statement of activities (as depreciation expense should be allocated among the functions when presenting functional expense information). If an NFP really wants to show depreciation as nonoperating, perhaps a solution would be to use natural expense information on the face of the statement of activities **and/or** include a footnote to fully functionalize expenses including depreciation.

The Statement of Functional Expenses

The Statement of Functional Expenses

Learning Objectives

	Upon completing this chapter, you will be able to: • Perceive key issues related to the statement of functional expenses; and • Understand how the statement of functional expenses can be tailored to fit the NFP and meet the needs of resource providers.

I. The statement of functional expenses

Current and prospective resource providers naturally want to know how an NFP uses (i.e., expends) its resources. In fact, resource providers are interested in how NFPs expend their resources from two different perspectives. The first perspective relates to how expenses were incurred by **function** (e.g., program, management and general, and fundraising). The second perspective relates to how expenses were incurred by **nature** (e.g., salaries and wages, utilities, and depreciation). Recognizing the importance of both perspectives to resource providers, the FASB requires NFPs to present information regarding expenses by **function and nature** (or as some prefer to say "nature and function") in one location (typically in a matrix type format).

	Presenting an analysis of all expenses by function and nature Under FASB ASC 958, **all** NFPs are required to report information about **all** expenses **in one location** either: [1] on the face of the statement of activities; [2] as a schedule in the notes to the financial statements; or [3] in a separate financial statement (e.g., a statement of functional expenses). The relationship between functional classification and natural classification for all expenses is required to be presented in an analysis that disaggregates **functional expense classifications** (e.g., major classes of program services and supporting activities) by their **natural expense classifications** (e.g., salaries, rent, electricity, supplies, interest expense, depreciation, awards and grants to others, and professional fees).

Note. In this course, we will frequently refer to the above analysis of all expenses by function and nature as the **statement of functional expenses**. However, as we have already seen, this information could also be presented as a disclosure or as part of the statement of activities. The following chart provides some additional points about the analysis of all expenses by function and nature.

A couple of points about the analysis of all expenses by function and nature	
	To the extent that expenses are reported by other than their natural classification (e.g., salaries included in cost of goods sold or facility rental costs of special events reported as direct benefits to donors) they are required to be reported by their natural classification in the analysis of expenses by nature and function. As an example, salaries, wages, and fringe benefits that are included as part of the cost of goods sold on the statement of activities are required to be included with other salaries, wages, and fringe benefits in the analysis of expenses by nature and function.
	External and direct internal investment expenses that have been netted against investment return are not included in the analysis of expenses by nature and function.

A. Exercise 4-1

Please answer the following true or false question.

		True or False
1	Under FASB ASC 958, NFPs may report the required information about functional and natural expenses on the face of the statement of activities. Many NFPs choose this option.	

II. Key statement of functional expenses concepts

In this section of the course, we want to explore some key concepts related to the statement of functional expenses beginning with a discussion of the natural and functional classification of expenses.

A. The natural classification of expenses

Information about the natural classification of expenses helps resource providers understand how amounts were expended within the functional classifications.

Why is natural expense information important?

Natural expense classification (i.e., the grouping of expenses according to the kinds of economic benefits received in incurring those expenses like salaries and wages, employee benefits, professional services, supplies, interest expense, rent, utilities, and depreciation) is helpful to many financial statement users. For example, natural expense information is helpful in distinguishing costs that are possibly variable (e.g., travel) as opposed to fixed (e.g., depreciation). This information can be very helpful to those involved in the budgetary process of the NFP and creditors. Furthermore, some donors and grantors like seeing information about the amounts expended on salaries and wages, employee benefits, rent, and travel.

1. How many classifications of natural expenses should an NFP present?

NFPs have discretion over the number of natural expense classifications (i.e., categories) that they present in the statement of functional expenses. In presenting natural classifications of expenses, NFPs should thoughtfully consider the potential users of the information and the level of detail that will be useful to them from a materiality standpoint when disaggregating expenses. Many in the NFP community would make the case that between 5 to 10 classifications represents a good balance of not presenting too little information nor too much information. However, it is certainly not a one-size-fits-all type answer.

2. Exercise 4-2

Please answer the following true or false question.

		True or False
1	An NFP can never present too many classifications of natural expenses on the statement of functional expenses.	

B. The functional classification of expenses

Presenting expenses by **functional classification** (i.e., the grouping of expenses according to the purpose for which costs are incurred) provides financial statements users with useful information regarding mission fulfillment. Presenting information regarding the functional classification of expenses involves aggregating expenses into major classes of program services and supporting activities. Activities that typically make up **program services** and **supporting activities** are described below.

Activities that typically make up *program services* and *supporting activities*			
Program Services	**Supporting Activities**		
	Management and General	**Fundraising**	**Membership Development**
Activities that result in goods and services being distributed to beneficiaries, members, or customers that fulfill the purposes or mission for which the NFP exists.	Activities that are not directly identifiable with one or more program, fundraising, or membership development activities.	Activities undertaken to induce potential donors to contribute money, securities, services, materials, facilities, other assets, or time.	Include soliciting for prospective members and membership dues, membership relations, and similar activities.

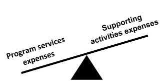
FASB ASC 958-720-45 provides more detailed descriptions and guidance related to program services, management and general activities, fundraising activities, and membership development activities.

1. Program services

As we saw in the prior chart, program services are the activities that result in goods and services being distributed to beneficiaries, members, or customers that fulfill the purposes or mission for which the NFP exists. Those services are the major purpose for and the major output of the NFP and often relate to several major programs. Because there are many different types of NFPs and the flexibility allowed within the standards, there is a great deal of variance in the categories of program services that appear in NFP financial statements as reflected in the following.

Singing to a different tune - Examples of program services presented in three different musical NFP financial statements		
New York Philharmonic	**Sarasota Orchestra**	**Fort Worth Symphony Orchestra Association**
Subscription series Non-subscription concerts Touring concerts Education Fixed artistic	Orchestra and chamber orchestras/ensembles Music festival Music education programs	Program

Program service expenses are the direct and indirect costs of providing the program(s). Providing information about program services expenses provides important information to donors and others. For example, in the case of the Sarasota Orchestra, some donors may be interested in the amounts expended on orchestra and chamber orchestras/ensembles as compared to amounts spent on music education programs.



Pressure to have a high ratio of program services expenses

For many NFPs, there is tremendous pressure to have a high ratio of expenses in the program services category and a low ratio of expenses in the supporting activities category. There are several websites available to donors and others to readily compare the amounts expended on program services to other expenses and also with other organizations (e.g., www.charitynavigator.org or www.guidestar.org). These websites can also be a tool for auditors in comparing a particular NFP client to other NFPs with a similar mission.

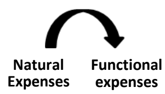
2. Supporting activities

FASB ASC 958-720-45 provides three common categories of supporting activities and examples of activities occurring within the categories as reflected in the following.

Examples of Supporting Activities		
Management and General	**Fundraising**	**Membership Development**
All management and administration except for direct conduct of program services, fundraising activities, or membership development activities	Preparing and distributing fundraising manuals, instructions, and other materials	Soliciting for prospective members and membership dues
Business management	Maintaining donor mailing lists	Membership relations
Financing, including interest costs that cannot be allocated	Conducting special fundraising events	Similar activities
Announcements concerning appointments	Publicizing and conducting fundraising campaigns	Note: If there are no significant benefits or duties connected with membership, however, the substance of membership development activities may, in fact, be fundraising, and the related costs reported as fundraising costs
Administering government, foundation, and similar customer-sponsored contracts, including billing and collecting fees, and grant and contract financial reporting	Conducting other activities involved with soliciting contributions from individuals, foundations, government agencies, and others	
Soliciting funds other than contributions and membership dues		
Disseminating information to inform the public of the NFP's stewardship of contributed funds		
Oversight		
The annual report		
Employee benefits management and oversight (human resources)		
Budgeting		
General recordkeeping and payroll		

3. Determining the functional expense classification of expenses

Providing expense information by **functional classification** is different from providing information by the more traditional **natural classification**. Typically, expenses originate in their natural expense classification. For example, an NFP pays an electricity bill and records utilities expense (i.e., a natural expense classification). Some natural expenses are relatively easy to directly convert to functional expenses (e.g., travel expenses incurred in connection with a program are easily assigned to that program functionally). Other natural expenses require allocation to arrive at functional expenses (e.g., rent for a building that houses both program and supporting activities).



Getting from natural expenses to functional expenses

Getting from natural expenses to functional expenses involves: (1) where natural expenses can be specifically identified with a program or supporting service assigning those expenses directly to that function; and (2) where natural expenses cannot be specifically identified with a program or supporting service reasonably allocating the natural expenses among the applicable functions.

A reasonable allocation of expenses among functions can be made on a variety of bases. Objective methods of allocating expenses are preferable to subjective methods. The allocation may be based on related financial or nonfinancial data. The allocation methods utilized by NFPs affect more than just the presentation of functional expenses. For example, the allocation methods may also affect the reclassification of net assets with donor restrictions to net assets without donor restrictions if purpose restrictions exist. The following chart contains some additional comments/guidance related to the allocation of expenses.

Additional comments/guidance related to the allocation of expenses include…	
	Under FASB ASC 958-720-45, interest costs, including interest on a building's mortgage, should be allocated to specific programs or supporting services to the extent possible. Interest costs that cannot be allocated are reported as part of the management and general function.
	Under FASB ASC 958-720-45, occupying and maintaining a building is not a separate supporting service.
	The AICPA Audit & Accounting Guide, *Not-for-Profit Entities*, provides that the expenses associated with occupying and maintaining a building, such as depreciation, utilities, maintenance, and insurance, may be allocated among the NFP's functions based on the square footage of space occupied by each program and supporting service. If floor plans are not available and the measurement of the occupied space is impractical, an estimate of the relative portion of the building occupied by each function may be made.
	An NFP should periodically (e.g., annually) review the allocation methods utilized and revise them when necessary to reflect significant changes in the nature or level of the NFP's current activities. In reviewing the allocation methods, the NFP may look at items such as time records or activity reports of key personnel, the utilization of space, and the consumption of supplies and postage.

NFPs often use account coding in the general ledger to collect and group expenses on both a natural and functional basis. Allocations may occur via several means such as: (1) through a computerized program; (2) coding assigned when invoices are submitted/entered into the accounts payable system; and (3) adjusting journal entries. At different times, expense information on both a natural and functional basis is needed for internal budgeting, compliance with grant and donor restrictions, and financial reporting.

4. FASB ASC 958 provides additional guidance related to expense allocations

As we have seen, certain costs benefit more than one function and, therefore, will be allocated. As discussed in the below, FASB ASC 958 provides additional guidance in this area in form of illustrations.

FASB ASC 958 provides some additional illustrations of allocation determinations including…	
	Information technology generally can be identified as benefiting various functions, such as management and general (e.g., accounting and financial reporting and human resources), fundraising, and program delivery. Therefore, information technology costs generally would be allocated among the functions receiving direct benefit.
	A CEO's broad responsibilities generally include administrative and programmatic oversight. At NFP X, the CEO spends a portion of time directly overseeing the research program. Additionally, a portion of time is spent with current and potential donors on fundraising cultivation activities. A portion of the CEO's compensation and benefits and other expenses would be allocated to the research program and to the fundraising function representing the portion of time spent on those activities because they reflect direct conduct or direct supervision. If the remainder of the CEO's time is spent indirectly supervising the other areas of NFP X, including the administrative areas, those activities would not constitute direct conduct or direct supervision, and the ratable portion of compensation and benefit amounts would remain in management and general activities.
	The HR department at NFP Y generally is involved in the benefits administration for all personnel of NFP Y. The HR department's related costs would not be allocated to any specific program. Rather, those costs would remain a component of management and general activities because benefits administration is a supporting activity for the entire entity.
	NFP Z receives federal grants and employs an accountant who is responsible for grant accounting and reporting. In some cases, under the terms of the grant agreement, a fiscal report is required to be filed that details expenses incurred and charged against the grant. The fiscal report is not part of the direct conduct or direct supervision of the grant but rather is an accounting function. Therefore, the grant accountant's compensation and benefits would not be allocated to the programmatic area. However, a scientific report prepared by a principal investigator who is responsible for the research activity would be indicative of direct conduct and/or direct supervision of the grant activity, and the principal investigator's compensation and benefits would be allocated to the grant.

5. Exercise 4-3

Please answer the following true or false question.

		True or False
1	Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities.	

6. The classification of expenses that include fundraising

It is not unusual for NFPs to conduct activities that have a shared programmatic and fundraising purpose (e.g., direct mail campaigns, special events, and telephone solicitations). For these activities, joint costs should be considered for allocation following the detailed guidance and tests found in FASB ASC 958-720. If costs are deemed to be allocable, the next step is to ensure there is a rational and systematic basis for allocation between fundraising and the respective programmatic areas. Allocation methods to consider (which are illustrated in FASB ASC 958-720) include the physical-units method, the relative-direct-costs method, and the standalone method.

The following chart discusses key disclosure requirements related to expenses that include fundraising.

NFPs have disclosure requirements related to expenses that include fundraising including:	
✓	NFPs that allocate joint costs disclose all of the following in the notes to the financial statements: (1) the types of activities for which joint costs have been incurred; (2) a statement that such costs have been allocated; and (3) the total amount allocated during the period and the portion allocated to each functional expense category. NFPs are encouraged, but not required, to disclose the amount of joint costs for each kind of joint activity, if practical.
✓	NFPs will also disclose total fundraising expenses.

7. Choices NFPs are making

Natural to functional expense allocations vary from one NFP to another. There are several reasonable allocation approaches that may make sense, **and** NFPs will have different allocation methodologies depending on the expenses in question. In the 100 audited NFP financial statements the author reviewed for the course, the author noted the following: (1) in many cases it was difficult to determine the specific allocation methodologies utilized as the footnotes were written very broadly; (2) approximately 60% of NFPs specifically discussed using time and effort studies as a basis for allocating costs; (3) approximately 50% of NFPs specifically discussed using square footage as a basis for allocating costs; and (4) approximately 15% of NFPs specifically discussed using headcount as a basis for allocating costs. The author also noted that: (1) a few NFPs mentioned allocating interest expense based on the functional categories that benefited from the proceeds of a debt issuance; and (2) a few NFPs mentioned allocating information technology costs based on the number of machines.

8. Disclosures related to expense allocation

FASB ASC 958 contains a disclosure requirement related to expense allocation as discussed in the following chart.

📎	**FASB ASC 958 contains a disclosure requirement related to expense allocation** Under FASB ASC 958, NFPs are required to disclose **a description of the methods used to allocate costs among program and support functions**.

The following chart illustrates what the additional FASB ASC 958 disclosure describing the methods used to allocate costs among program and support functions might look like. (**Note.** In the author's review of 100 audited financial statements, many NFPs presented a footnote comparable to the below.)

A disclosure describing the methods used to allocate costs among program and support functions might look like…
Note F – Methods used for allocation of costs among program and support functions The financial statements of NFP J report certain categories of expenses that are attributable to more than one program or supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include depreciation, office, and occupancy, which are both allocated on a square footage basis, as well as salaries and benefits, which are allocated on the basis of time and effort studies.

Below is another illustration of a disclosure describing the methods used to allocate costs among program and support functions.

Another example of a disclosure describing the methods used to allocate costs among program and support functions might look like…
Note P – Methods used for allocation of expenses among functions The financial statements of NFP K report certain categories of expenses that are attributable to more than one program or supporting function. Those expenses include depreciation and amortization, the CEO's office, communications department, and information technology department. Depreciation is allocated based on square footage, the CEO's office is allocated based on estimates of time and effort, certain costs of the communications department are allocated based on estimates of time and effort, and the information technology department is allocated based on estimates of time and costs of specific technology utilized.

In the 100 audited financial statements the author reviewed for the course, many NFPs presented disclosures comparable to the examples we just observed. The following charts illustrate a couple of the disclosures found in the reviewed statements.

The following disclosure (from one of the 100 audited NFP f/s reviewed for the course) provided financial statement users with a good description of the methods used to allocate costs
Allocation of Certain Expenses The statement of functional expenses presents expenses both by functional and natural classification. Certain categories of expenses are attributable to one or more program or supporting functions, and these expenses are allocated to the reported functional columns. These allocated expenses include salaries, benefits, contracted professionals, rent, telephone, repairs and maintenance, and utilities, among others. Salaries, benefits, and contracted professionals for employees working in multiple programs are allocated based on time studies performed throughout the year. Rent, equipment leases, insurance, utilities, and repairs and maintenance are allocated based on square footage of workspace at each location. Telephone expenses are allocated by the number of lines or extensions used by the program. Database and IT expenses are allocated based on the number of users that are supported. Vehicle related expenses including mileage and fuel are allocated based on mileage logs submitted.

The following disclosure (from one of the 100 audited NFP f/s reviewed for the course) provided financial statement users with no information regarding the methods used to allocate costs

Expense Allocation

The costs of providing various programs and other activities have been summarized on a functional basis in the statements of activities and functional expenses. Accordingly, certain costs have been allocated among the programs and supporting services benefited.

III. Illustrations of the statement of functional expenses

The following chart illustrates what the analysis of all expenses by function and nature might look like as a separate financial statement (e.g., a statement of functional expenses).

NFP D
Statement of Functional Expenses
Year Ended September 30, 20X1

	Program Activities		Supporting Activities		
	Omega	Iota	Management and General	Fundraising	Total Program and Supporting Activities
Salaries and benefits	$54,020	$37,440	$18,744	$12,196	$122,400
Grants to other organizations	15,148	7,200			22,348
Supplies and travel	6,314	9,600	3,960	7,000	26,874
Services and professional fees	1,168	14,304	3,300	4,875	23,647
Office and occupancy	8,468	5,760	3,597	1,250	19,075
Depreciation	10,979	8,071	4,125	1,750	24,925
Interest	971	637	1,287	813	3,708
Total expenses	$97,068	$83,012	$35,013	$27,884	$242,977

The following chart illustrates what a disclosure providing an analysis of all expenses by function and nature might look like.

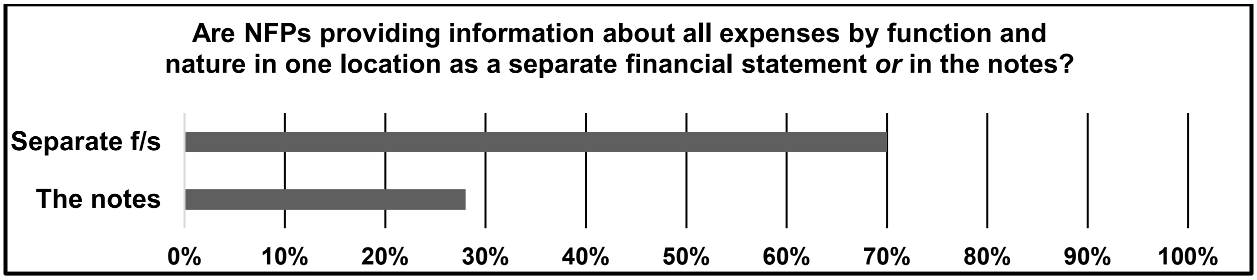
A disclosure providing an analysis of all expenses by function and nature might look like...

The table below presents NFP D's expenses by both their function and nature for fiscal year 20X1.

	Program Activities			Supporting Activities			
	Omega	Iota	Programs	Management and General	Fundraising	Supporting	Total Expenses
Salaries and benefits	$54,020	$37,440	$91,460	$18,744	$12,196	$30,940	$122,400
Grants to other organizations	15,148	7,200	22,348				22,348
Supplies and travel	6,314	9,600	15,914	3,960	7,000	10,960	26,874
Services and professional fees	1,168	14,304	15,472	3,300	4,875	8,175	23,647
Office and occupancy	8,468	5,760	14,228	3,597	1,250	4,847	19,075
Depreciation	10,979	8,071	19,050	4,125	1,750	5,875	24,925
Interest	971	637	1,608	1,287	813	2,100	3,708
Total expenses	$97,068	$83,012	$180,080	$35,013	$27,884	$62,897	$242,977

A. Choices NFPs are making

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course in terms of NFPs providing expenses by function and nature in one location.



Note. In looking at the 100 audited financial statements, we found that two percent of NFPs were incorrectly not presenting the analysis of expenses by function and nature at all.

IV. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

A. Suggested solution to Exercise 4-1

		True or False
1	Under FASB ASC 958, NFPs may report the required information about functional and natural expenses on the face of the statement of activities. Many NFPs choose this option.	**False.** Very few NFPs choose this option (e.g., the author did not observe this presentation in any of the 100 audited NFP financial statements reviewed for the course). The drawback to this approach is the verticality problems it causes on the statement of activities. For example, if a very simple NFP had only three functional expense categories and five natural expense categories, at least fifteen-line items would be used to present expenses in the single-column format.

B. Suggested solution to Exercise 4-2

		True or False
1	An NFP can never present too many classifications of natural expenses on the statement of functional expenses.	**False.** For natural classifications of expenses, sometimes providing less information equates to providing better information for the average donor. Too many natural expense line items makes the information hard to read and difficult to process. For example, in one of the audited financial statements the author reviewed for the course, an NFP presented approximately 80 different classifications of natural expenses! The statement of functional expenses was four pages long (and since a comparative year was presented, eight pages were presented).

C. Suggested solution to Exercise 4-3

		True or False
1	Activities that represent direct conduct or direct supervision of program or other supporting activities require allocation from management and general activities.	**True.** This statement appears at FASB ASC 958-720-45-2A

The Statement of Cash Flows

The Statement of Cash Flows

Learning Objective

Upon completing this chapter, you will be able to:

- Perceive key issues related to the statement of cash flows; and
- Understand how the statement of cash flows can be tailored to fit the NFP and meet the needs of resource providers.

I. The statement of cash flows

The statement of cash flows is one of the required financial statements for NFPs. While it is required, many NFPs and their resource providers find the statement of cash flows to be the least useful and most confusing of the basic financial statements. However, as discussed in the following chart, the statement of cash flows certainly provides some useful information (in theory).

Cashing in and cashing out

The statement of cash flows, used with related disclosures and information in the other financial statements, helps in assessing: (1) the NFP's ability to generate positive future net cash flows; (2) the NFP's ability to meet its obligations, its ability to provide resources, and its needs for external financing; (3) the reasons for differences between the change in net assets and associated cash receipts and payments; and (4) the effects on an NFP's financial position of both its cash and noncash investing and financing transactions during the period.

II. Key statement of cash flows concepts

A statement of cash flows reports the cash effects during a period of an NFP's operations, its investing transactions, and its financing transactions. For NFPs using the indirect method, it also provides a reconciliation of the change in net assets to net cash flow from operating activities. To achieve this, the statement of cash flows is required to report certain items as illustrated in the following chart.

The statement of cash flows is required to report all of the following amounts for the period:

Statement of Cash Flows

- ← **The change in net assets (if using the indirect method)**
- ← **Net cash provided/used by operating activities**
- ← **Net cash provided/used by investing activities**
- ← **Net cash provided/used by financing activities**
- ← **Net increase/decrease in cash and cash equivalents**
- ← **Cash and cash equivalents at the beginning of the year**
- ← **Cash and cash equivalents at the end of the year**

A. Exercise 5-1

Please answer the following true or false question.

		True or False
1	For the typical NFP financial statement user, the net cash provided/used by financing activities is the most important number on the statement of cash flows.	

B. Cash flows from operating, investing, and financing activities

A statement of cash flows classifies and reports cash receipts and cash payments as resulting from operating, investing, or financing activities.

What are operating, investing, and financing activities?		
Operating activities	**Investing activities**	**Financing activities**
Operating activities include all transactions and other events that are not defined as investing or financing activities. Operating activities generally involve producing and delivering goods and providing services. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of change in net assets.	Investing activities include making and collecting loans and acquiring and disposing of debt or equity instruments and property, plant, and equipment and other productive assets, that is, assets held for or used in the production of goods or services by the entity (other than materials that are part of the entity's inventory). Investing activities exclude acquiring and disposing of certain loans or other debt or equity instruments that are acquired specifically for resale.	Financing activities include receiving restricted resources that by donor stipulation must be used for long-term purposes; borrowing money and repaying amounts borrowed, or otherwise settling the obligation; and obtaining and paying for other resources obtained from creditors on long-term credit.

C. A potential adjustment needed for restricted contributions

As discussed in the above chart, if an NFP receives a cash contribution that by donor stipulation is restricted for long-term purposes (e.g., acquiring long-lived assets or increasing a donor-restricted endowment) those amounts are reported as inflows from financing activities. If an NFP uses the indirect method of reporting cash flows, an adjustment is needed to reconcile the net cash flows from operating activities as illustrated in the following chart.

The following NFP adjusted net cash flows from operating activities due to gifts received that were restricted to long-term investment		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ 606,480	84,391
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	11,406	11,021
Amortization of bond premium and cost of issuance	51	37
Net gains from investments and trusts	(598,399)	(93,562)
Gifts received for long-term investment	(28,898)	(23,077)
Gifts of property, plant and equipment	(154)	(1,095)
Postretirement benefit obligation change	88	1,499
Changes in assets and liabilities that provide (use) cash:		
Receivables, net and other assets	(1,101)	(583)
Pledges receivable, net	(5,879)	(6,935)
Accounts payable	(3,505)	(640)
Student deposits and deferred revenues	(988)	3,050
Change in valuation of split-interest obligations	1,150	885
Asset retirement obligation	73	(623)
NET CASH USED IN OPERATING ACTIVITIES	(12,666)	(25,632)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Additions to property and equipment	(21,729)	(27,289)
Change in deposit with brokers for short sales	(12,582)	(3,311)
Purchases of securities sold short	(2,706)	(8,329)
Sales of securities sold short	10,770	14,172
Purchases of long-term investments	(354,825)	(235,422)
Sales of long-term investments	387,492	285,418
Purchases of short-term investments	(134,528)	(339,677)
Sales of short-term investments	111,386	234,153
NET CASH USED IN PROVIDED BY INVESTING ACTIVITIES	(16,722)	(80,285)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Gifts received for long-term investment	28,898	23,077
Payments to beneficiaries of split-interest agreements	(908)	(213)
Draws on line of credit	—	5,000

D. Two methods for reporting cash flows from operating activities

For NFPs using the **indirect method**, the statement of cash flows provides a reconciliation of the change in total net assets to net cash flow from operating activities. For NFPs using the **direct method**, the statement of cash flows provides the principal components of operating cash receipts and payments (e.g., cash received from contributors, cash paid to employees and suppliers, etc.) the sum of which is net cash flow from operating activities.

Two methods for reporting cash flows from operating activities

An NFP may choose either the direct or indirect method of reporting cash flows from operating activities. Under FASB ASC 958, if the direct method is used, a reconciliation to the indirect method (i.e., disclosing the indirect reconciliation of the change in total net assets to net cash flow from operating activities) **may be reported but is not required**.

1. Exercise 5-2

Please answer the following true or false question.

		True or False
1	NFPs that prepare the statement of cash flows using the direct method rarely present the indirect reconciliation of the change in total net assets to net cash flow from operating activities as they are not required to.	

E. Cash and cash equivalents

A statement of cash flows explains the change during the period in cash and cash equivalents. The statement uses descriptive terms such as *cash* or *cash and cash equivalents* rather than ambiguous terms such as funds. The total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows will articulate to the amounts of similarly titled line items or subtotals shown in the statements of financial position as of those dates.

What is a cash equivalent?
FASB ASC 230-10-20 provides that cash equivalents are short-term, highly liquid investments that have both of the following characteristics: (1) readily convertible to known amounts of cash; and (2) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or less qualify under the above definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, and money market funds.

Not all assets of NFPs that meet the definition of cash equivalents are cash equivalents for purposes of preparing statements of financial position and cash flows. Restrictions can prevent them from being included as cash equivalents even if they otherwise qualify. For instance, short-term highly liquid investments are not cash equivalents if they are purchased with resources that have donor-imposed restrictions that limit their use to long-term investment.

F. Other unique NFP guidance relating to the statement of cash flows

The statement of cash flows for an NFP is similar to the statement of cash flows prepared for a for-profit entity. However, as we have seen, there is some uniqueness to an NFP's statement of cash flows. An NFP should follow the unique guidance relating to the statement of cash flows in FASB ASC 958-230 and all effective provisions of the FASB ASC unless the specific provision explicitly exempts NFPs, or its subject matter precludes such applicability. Thus, NFPs apply the guidance in FASB ASC 230, *Statement of Cash Flows*, that does not conflict with the industry guidance.

Other unique NFP guidance relating to the statement of cash flows found in FASB ASC 958-230	
✓	Cash received and paid in agency transactions should be reported as cash flows from operating activities in a statement of cash flows. If the statement of cash flows is presented using the indirect method, cash received and paid in such transactions is permitted to be reported either gross or net.
✓	Cash flows from purchases, sales, and insurance recoveries of unrecognized, noncapitalized collection items should be reported as investing activities in a statement of cash flows.
✓	When an NFP reports cash received (or cash receipts from the sale of donated financial assets that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash as discussed in FASB ASC 230-10-45-21A) with a donor-imposed restriction that limits its use to long-term purposes in conformity with FASB ASC 958-210-45-6, an adjustment is necessary as discussed at FASB ASC 958-230-55-3.

G. Key disclosures related to the statement of cash flows

The following chart discusses several key disclosure requirements related to the statement of cash flows.

NFPs have several disclosure requirements related to the statement of cash flows including:	
✓	An NFP should disclose its noncash investing and financing activities.
✓	If the indirect method is used, amounts of interest paid (net of amounts capitalized) and income taxes paid during the period are required to be disclosed.
✓	An NFP should disclose its policy for determining which items are treated as cash equivalents.
✓	An NFP should provide information about restrictions on cash and cash equivalents as discussed in FASB ASC 230-10-50-7.

H. A couple of suggestions for keeping it simple

As we discussed earlier, many NFPs and their resource providers find the statement of cash flows to be the least useful and most confusing of the basic financial statements. Unlike the other financial statements, sometimes it is difficult for resource providers to know exactly what they should take away from reading the statement (although certainly one of the key take-a-ways should be the net cash provided/used by operating activities number). In order to assist resource providers in understanding the statement and the key numbers on it, NFPs should try to make the statement of cash flows as readily understandable as possible. In this section, we will examine a couple of suggestions to make the statement of cash flows focused and easier to understand.

1. Cutting back on the wording used in the statement of cash flows

How do you make a financial statement that is difficult to understand more difficult? You include too many words on it. So, one solution is to incorporate “changes in” wording into the operating activities section in place of the “increase/decrease” wording. This solution also assists in avoiding the problem of getting the wording and brackets mixed up (which is easy to do). The following charts show excerpts from two of the 100 audited NFP financial statements reviewed for the course.

The following NFP used the traditional “increase/decrease” wording in the operating activities section of the statement of cash flows and it resulted in a fair amount of excess wording

(Increase) decrease in accounts receivable	(222,951)	(34,367)
(Increase) decrease in employee loans receivable	(248,904)	-
(Increase) decrease in prepaid expenses and other assets	(42,065)	39,891
(Increase) decrease in noncurrent other assets	(240,176)	-
Increase (decrease) in accounts payable	(490,521)	583,869
Increase (decrease) in noncurrent accrued liabilities	180,000	180,000

The following NFP incorporated the "changes in" wording in the operating activities section of the statement of cash flows and it resulted in less wording		
Changes in operating assets and liabilities:		
Interest and dividends receivable	**54,364**	8,319
Accounts receivable	**117,646**	96,185
Prepaid expenses	**10,454**	(338)
Inventories	**107,156**	38,636
Accounts payable and accrued expenses	**198,003**	(33,860)
Deferred revenue	**(153,178)**	58,231

2. Exercise 5-3

Please answer the following true or false question.

		True or False
1	A good number of NFPs opt to use the "changes in" wording in the operating activities section of the statement of cash flows.	

3. Cutting back on the line items used in the statement of cash flows

How do you keep a resource provider from focusing on the most important line items? You include too many line items on it. By nature, the statement of cash flows already has a lot of line items on it. One solution to improve the readability/focus of the statement is to collapse some of the line items listed into one line item. The following charts show excerpts from two of the 100 audited NFP financial statements reviewed for the course. **Note.** These are larger NFPs and the numbers presented are in the thousands.

The following NFP devoted many line items to reflect the changes in operating assets and liabilities		
Changes in operating assets and liabilities:		
(Increase) decrease in:		
Receivables, net	(7,880)	(16,817)
Pledges receivable	(1,932)	(2,943)
Supplies inventory	(224)	(715)
Prepaid expenses	(496)	(2,568)
Other current assets	476	279
Other long-term receivables	1,477	355
Prepaid pension	—	1,946
(Decrease) increase in:		
Accounts payable	847	3,308
Accrued liabilities	(5,562)	6,976
Deferred revenues	—	(14,029)
Accrued interest payable	(272)	1,970
Payable to third-party agencies	633	1,629
Pension liability	(5,438)	5,438
Other long-term liabilities	(564)	612

The following NFP collapsed the changes in operating assets and liabilities.

The following NFP consolidated multiple line items to reflect the changes in operating assets and liabilities		
Changes in operating assets and liabilities:		
Accounts receivable, deferred charges and other assets	(672)	(6,376)
Accounts payable, deferred revenue and refundable advances, and deposits and other liabilities	31,851	60,274

III. Illustrations of the statement of cash flows

In this section of the course, we are going to look at two illustrations of the statement of cash flows. The first statement utilizes the indirect method and the second utilizes the direct method.

A. The indirect method

The following is an illustrative statement of cash flows which utilizes the frequently used indirect method.

NFP K	
Statement of Cash Flows for the Year Ended June 30, 20X3	
Cash flows from operating activities:	
Change in net assets	$37,033
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation	7,699
Increase in accounts and interest receivable	(1,444)
Increase in inventories and prepaid expenses	(2,002)
Increase in contributions receivable	(4,777)
Decrease in accounts payable	(548)
Decrease in grants payable	(887)
Contributions restricted for long-term investment	(14,002)
Interest and dividends restricted for reinvestment	(6,156)
Realized and unrealized gains on investments	(754)
Net cash provided by operating activities	14,162
Cash flows from investing activities:	
Purchase of equipment	(7,025)
Proceeds from sale of investments	22,074
Purchase of investments	(27,568)
Net cash used by investing activities	(12,519)
Cash flows from financing activities:	
Proceeds from contributions restricted for:	
Investment in endowment	4,321
Investment in land	8,784
Other financing activities:	
Interest and dividends restricted for reinvestment	6,156
Payments on notes payable	(4,995)
Net cash provided by financing activities	14,266
Net increase in cash and cash equivalents	15,909
Cash and cash equivalents at beginning of year	7,548
Cash and cash equivalents at end of year	$23,457
Supplemental data:	
Noncash investing and financing activities:	
Gift of land	$10,000
Interest paid	4,123

B. The direct method

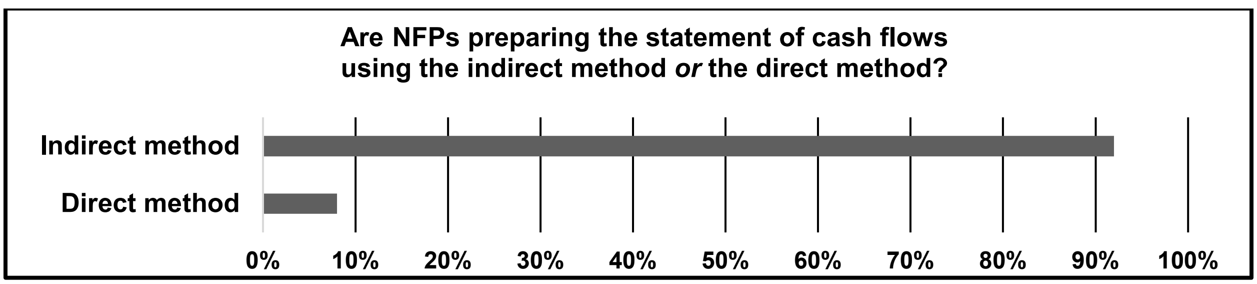
The following is an illustration of a statement of cash flows using the direct method which excludes the indirect reconciliation of the change in total net assets to net cash flow from operating activities.

NFP K
Statement of Cash Flows for the Year Ended June 30, 20X3

Cash flows from operating activities:	
Cash received from contributors	$117,298
Cash received from service recipients	41,995
Cash collected on contributions receivable	27,026
Interest and dividends received	9,254
Interest paid	(4,123)
Cash paid to employees and suppliers	(171,289)
Grants paid	(5,999)
Net cash provided by operating activities	14,162
Cash flows from investing activities:	
Purchase of equipment	(7,025)
Proceeds from sale of investments	22,074
Purchase of investments	(27,568)
Net cash used by investing activities	(12,519)
Cash flows from financing activities:	
Proceeds from contributions restricted for:	
Investment in endowment	4,321
Investment in land	8,784
Other financing activities:	
Interest and dividends restricted for reinvestment	6,156
Payments on notes payable	(4,995)
Net cash provided by financing activities	14,266
Net increase in cash and cash equivalents	15,909
Cash and cash equivalents at beginning of year	7,548
Cash and cash equivalents at end of year	$23,457
Supplemental data for noncash investing and financing activities:	
Gift of land	$10,000

C. Choices NFPs are making

The following chart reflects what the author observed in the audited financial statements of 100 NFPs reviewed for the course in terms of preparing the statement of cash flows.



D. Exercise 5-4

Please review and complete the below.

Are there any benefits to using the indirect method (other than ease of preparation)?
As we have observed, there is a strong preference within the NFP community to prepare the statement of cash flows using the indirect method. The direct method is more difficult to prepare as it involves taking the NFP's revenues and expenses and then adding and subtracting the beginning and ending balances for things like receivables, payables, etc. Besides ease of preparation, are there any other benefits to NFPs using the indirect method?

IV. Suggested solutions to exercises

This section contains the suggested solutions to the exercises presented in the chapter.

A. Suggested solution to Exercise 5-1

		True or False
1	For the typical NFP financial statement user, the net cash provided/used by financing activities is the most important number on the statement of cash flows.	**Generally false.** Typically, the **net cash provided/used by operating activities** is a more important number as it provides an estimate of an NFP's ability to generate cash flows from its normal day to day activities. This number may be even more important for NFPs than for-profit entities as the ability to generate cash from operating activities can be critical to NFPs even in the short-term (e.g., as some NFPs may have less ability to borrow money than for-profits).

B. Suggested solution to Exercise 5-2

		True or False
1	NFPs that prepare the statement of cash flows using the direct method rarely present the indirect reconciliation of the change in total net assets to net cash flow from operating activities as they are not required to.	**False (depending upon one's definition of rarely).** For example, in the 100 audited financial statements that the author reviewed for the course, 38% of NFPs which used the direct method also presented the indirect reconciliation.

C. Suggested solution to Exercise 5-3

		True or False
1	A good number of NFPs opt to use the "changes in" wording in the operating activities section of the statement of cash flows.	**True.** In roughly two-thirds of the 100 audited financial statements that the author reviewed for the course, NFPs used the "changes in" wording in the operating activities section.

D. Suggested solution to Exercise 5-4

Are there any benefits to using the indirect method (other than ease of preparation)?

As we have observed, there is a strong preference within the NFP community to prepare the statement of cash flows using the indirect method. The direct method is more difficult to prepare as it involves taking the NFP's revenues and expenses and then adding and subtracting the beginning and ending balances for things like receivables, payables, etc. Besides ease of preparation, are there any other benefits to NFPs using the indirect method?

The FASB and some lenders prefer the direct method as it better reflects the operating cash receipts and payments of the NFP. However, that does not mean that the indirect method does not have any theoretical benefits. In addition to ease of preparation, the indirect method focuses on the differences between the change in net assets and net cash flow from operating activities. This focus can be very helpful to resource providers who are interested in seeing how the change in net assets translated into operating cash flows during the period.

Latest Developments

This chapter is reserved for additional materials to be added throughout the year as appropriate. As this course went to press there were no latest developments to include.