

# About the Author



**Dr. Hrishikesh (Hrish) Desai**

**CPA, CFA, EA, CMA, FCA**

Associate Professor of Accounting

Director of the Master of Accountancy with Data Analytics Program

Arkansas State University

**Contact Information**

[Linkedin](#)

[Twitter](#)

[Instagram](#)

# Not-for-Profit Organizations

Not-for-profit organizations follow GAAP and accrual basis accounting, with unique accounting issues and terminology.

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# FASB-Defined Categories of Not-for-Profit Organizations



## Health Care Organizations

Hospitals, nursing homes, health maintenance organizations, continuing care retirement communities



## Voluntary Health and Welfare Organizations

Organizations deriving revenue primarily from public contributions for health, welfare, or community services (e.g., United Way, American Red Cross)



## Educational Institutions

Colleges, universities, community colleges, trade schools, private elementary and secondary schools



## Other Not-for-Profit Organizations

Cemetery, fraternal, labor unions, political parties, professional associations, religious, research, social and country clubs, trade associations, performing arts, museums, and libraries

# Defining Characteristics

## Revenue Sources

Revenues primarily come from contributions rather than sales of goods or services

## Operating Purpose

Mission does not include profit generation, though profits may occur

## Ownership Structure

Ownership interests differ fundamentally from business enterprises

The FASB defines not-for-profit organizations through these three essential characteristics that distinguish them from commercial entities.

# Financial Statement Users

## Primary Users

- Donors providing financial support
- Members participating in the organization
- Creditors extending credit
- Other resource providers

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# Full Accrual Basis Accounting

## GAAP Requirement

Not-for-profit organizations must report using full accrual basis accounting under GAAP

## Reporting Emphasis

Primary focus on disclosing sources of resources and how they were expended

## Organization-Wide Focus

Overall emphasis on basic information for the organization as a whole

📌 **Important:** External financial statements do not present funds, unlike governmental entities. This is a key distinction in not-for-profit reporting.



# Required Financial Statements



## Statement of Financial Position

Equivalent to a commercial balance sheet, showing assets, liabilities, and net assets



## Statement of Activities

Equivalent to a commercial income statement and statement of changes in retained earnings



## Statement of Cash Flows

Equivalent to a commercial statement of cash flows using either direct or indirect method

# Statement of Financial Position Components



## Assets

Resources controlled by the organization, sequenced by nearness to cash



## Liabilities

OBLIGATIONS OF THE ORGANIZATION, sequenced by nearness to maturity



## Net Assets

Equity of the organization, classified with or without donor restrictions

The statement of financial position divides into these three major components, with specific presentation requirements for each category.

# Sample Statement of Financial Position

## Hope Community Center

As of December 31, 20XX

<b>ASSETS</b>	
<b>Current Assets:</b>	
Cash and cash equivalents	\$125,000
Accounts receivable (net)	\$35,000
Grants receivable	\$50,000
Prepaid expenses	\$8,000
<b>Total Current Assets</b>	<b>\$218,000</b>
<b>Non-Current Assets:</b>	
Property and equipment (net)	\$450,000
Endowment investments	\$200,000
<b>Total Non-Current Assets</b>	<b>\$650,000</b>
<b>TOTAL ASSETS</b>	<b>\$868,000</b>
<b>LIABILITIES</b>	
<b>Current Liabilities:</b>	
Accounts payable	\$25,000
Accrued expenses	\$15,000
Deferred revenue	\$10,000
<b>Total Current Liabilities</b>	<b>\$50,000</b>
<b>Non-Current Liabilities:</b>	
Long-term debt	\$180,000
<b>TOTAL LIABILITIES</b>	<b>\$230,000</b>
<b>NET ASSETS</b>	
Without donor restrictions	\$438,000
With donor restrictions	\$200,000
<b>TOTAL NET ASSETS</b>	<b>\$638,000</b>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<b>\$868,000</b>



# Net Asset Classifications

## Without Donor Restrictions

Available to finance general operations and may be expended at the governing board's discretion. Not restricted by external donor-imposed limitations.

### Includes:

- Board-designated endowment funds
- Board-designated net assets for future expenditure
- Unrestricted operating funds

## With Donor Restrictions

Subject to specific, externally imposed limitations made by donors. Nature and amounts must be reported in statements or notes.

### Examples:

- Support of particular operating activities
- Investment for specified terms
- Use in specified periods
- Acquisition of long-lived assets
- Perpetual endowments

# Critical Distinction: Board Designations

## Important

Internal board-designated funds are classified as **net assets without donor restrictions**.

### **Board Action $\neq$ Donor Restriction**

Board designations are internal decisions that do not create external restrictions

### **Reversible Decisions**

The board can reverse its own designations at any time

### **Classification Impact**

Always classified as unrestricted regardless of board intent

# Statement of Activities Elements

The statement of activities reports revenues and expenses (shown gross), gains and losses (often shown net), and reclassifications between classes of net assets.

## Change in Net Assets Without Donor Restrictions

Operating activities and unrestricted support

1

2

3

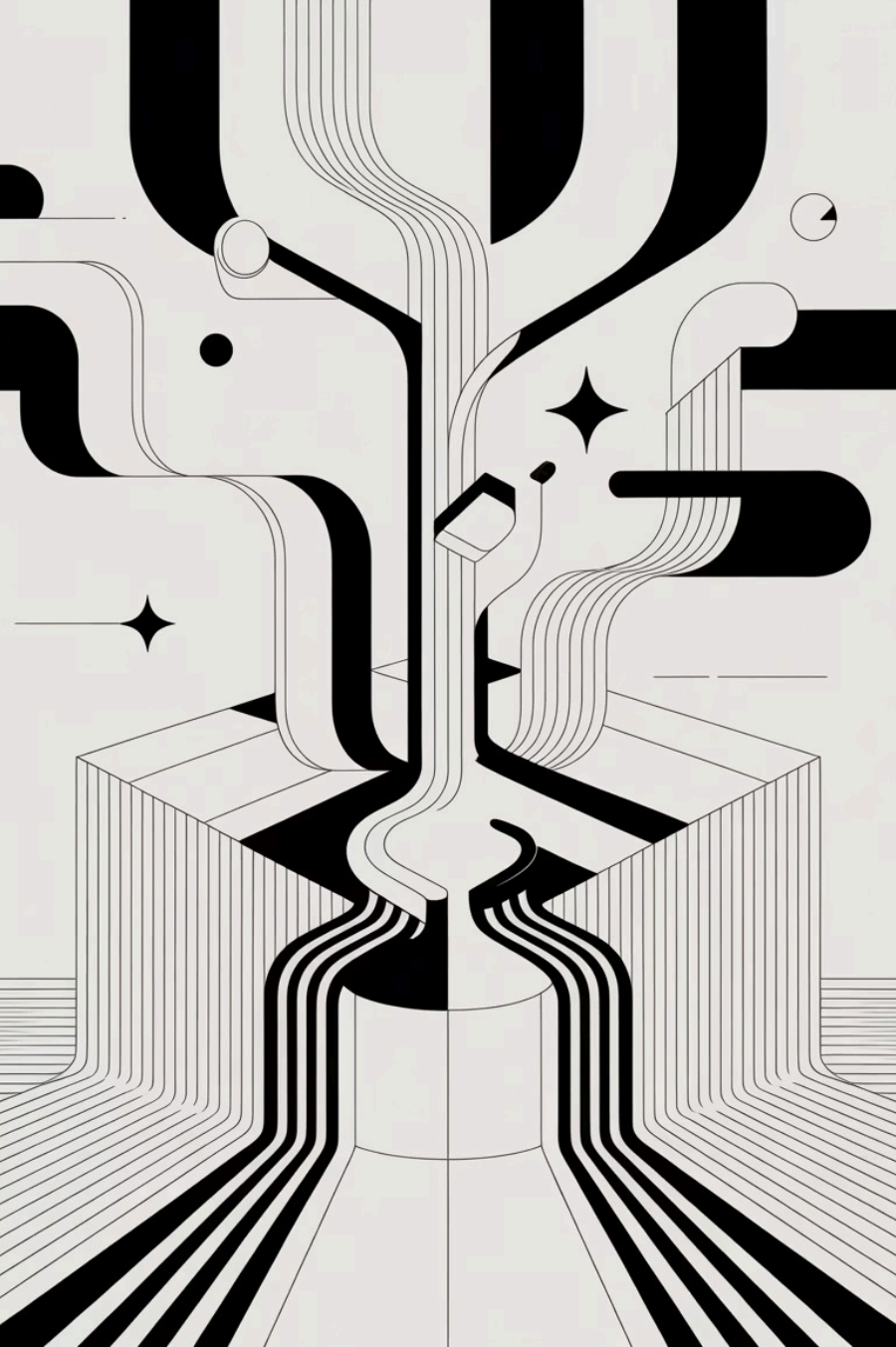
## Change in Total Net Assets

Combined changes from all sources

## Change in Net Assets With Donor Restrictions

Restricted contributions and investment returns

Preparers have latitude in presentation formats, sequencing data in various orders: revenues → expenses → gains → losses → reclassifications, or other logical arrangements that best present the organization's activities.



# Revenue Classification Principles

## Net Assets Without Donor Restrictions

Revenues classified as unrestricted unless use of assets received is limited by donor-imposed restrictions.

### Examples:

- Fees from rendering services
- Contributions with no explicit donor stipulation
- Investment gains without explicit restrictions
- Unrestricted grants

## Net Assets With Donor Restrictions

Revenues classified as restricted if asset use is limited by donor-imposed restrictions.

### Examples:

- Contributions for specified purposes
- Contributions subject to time passage
- Temporary restrictions
- Perpetual endowments

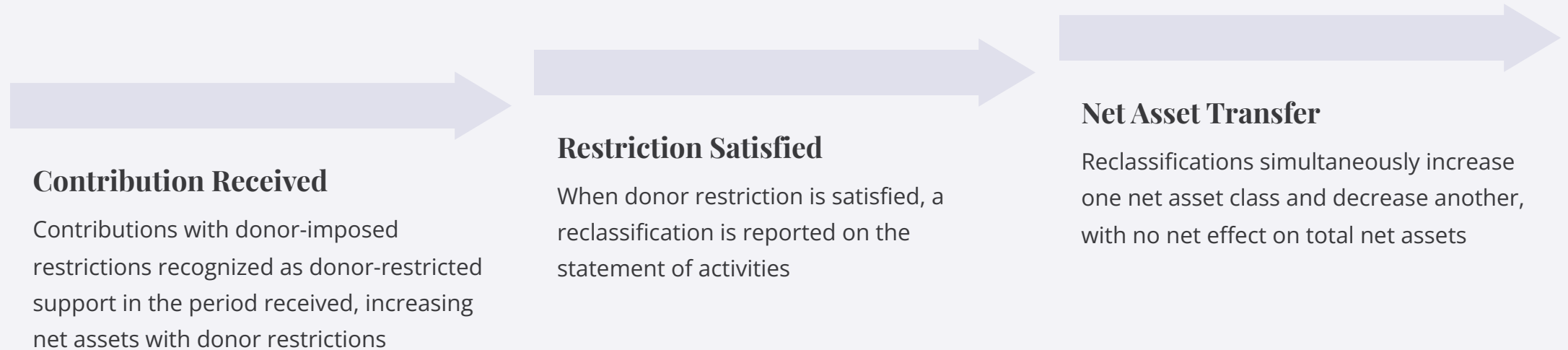
# Sample Statement of Activities

## Hope Community Center

For the Year Ended December 31, 20XX

<b>REVENUES AND SUPPORT</b>			
<b>Without Donor Restrictions:</b>			
Contributions	\$285,000		
Program service fees	\$125,000		
Investment income	\$18,000		
Net assets released from restrictions	\$75,000		
<b>Total Without Donor Restrictions</b>	<b>\$503,000</b>		
<b>With Donor Restrictions:</b>			
Contributions		\$95,000	
Investment income		\$12,000	
Net assets released from restrictions		\$(75,000)	
<b>Total With Donor Restrictions</b>		<b>\$32,000</b>	
<b>Total Revenues and Support</b>			<b>\$535,000</b>
<b>EXPENSES</b>			
<b>Program Services:</b>			
Community programs	\$285,000		
Educational services	\$145,000		
<b>Total Program Services</b>	<b>\$430,000</b>		
<b>Support Services:</b>			
Management and general	\$65,000		
Fundraising	\$28,000		
<b>Total Support Services</b>	<b>\$93,000</b>		
<b>Total Expenses</b>			<b>\$523,000</b>
<b>CHANGE IN NET ASSETS</b>			
Without donor restrictions	\$10,000		
With donor restrictions		\$32,000	
<b>Total Change in Net Assets</b>			<b>\$42,000</b>
<b>NET ASSETS, beginning of year</b>			<b>\$596,000</b>
<b>NET ASSETS, end of year</b>			<b>\$638,000</b>

# Reclassification Process



- ❏ **Special Rule:** Donor-imposed restrictions satisfied in the same period received may be recorded as an increase to net assets without donor restrictions, provided the organization discloses and consistently applies this accounting policy.

# Reclassification Example

This example illustrates how donor-restricted contributions are recognized and subsequently reclassified when the restriction is satisfied.

## Year 1 - Receipt of restricted donation:

Dr. Cash \$50,000  
Cr. Contributions - With Donor Restrictions \$50,000

Impact: Increases Net Assets With Donor Restrictions by \$50,000

## Year 2 - Purchase of equipment and reclassification:

Dr. Medical Equipment \$50,000  
Cr. Cash \$50,000

Dr. Net Assets Released from Restrictions \$50,000  
Cr. Net Assets - With Donor Restrictions \$50,000

The net effect is that total net assets are unchanged, but \$50,000 moves from the restricted category to the unrestricted category.

# Understanding the Reclassification Entry

This entry specifically reclassifies funds when donor restrictions have been satisfied, shifting them from one net asset category to another without altering total net assets.

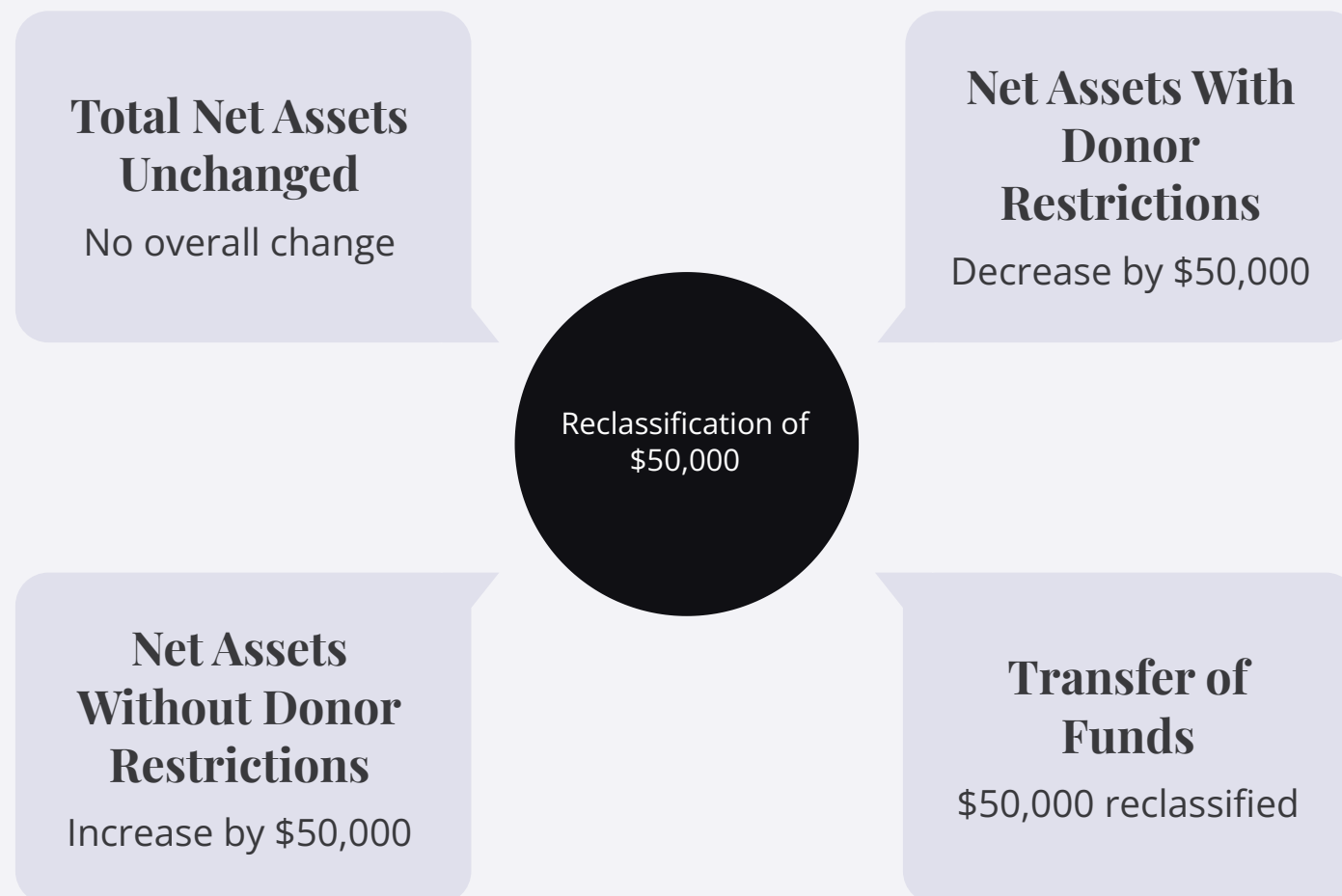
## On the Statement of Financial Position (Balance Sheet):

- Net Assets With Donor Restrictions decreases by \$50,000
- Net Assets Without Donor Restrictions increases by \$50,000
- Total Net Assets remains unchanged at the same amount

## On the Statement of Activities (Income Statement):

- "Net Assets Released from Restrictions" appears as a positive \$50,000 in the "Without Donor Restrictions" column
- "Net Assets Released from Restrictions" appears as a negative \$(50,000) in the "With Donor Restrictions" column
- These two amounts offset each other, so total revenues remain unchanged

**Key Point:** This is purely a reclassification - it moves money from one category to another without changing the total. It's like moving money from your savings account to your checking account - the total amount you have doesn't change, but the classification does.



# Expense Reporting Requirements

All not-for-profit organizations must report information about relationships between functional classifications and natural classifications of expenses in one location.

## Three Reporting Options

1. On the face of the statement of activities
2. As a schedule in the notes to financial statements
3. In a separate financial statement



**EXPENSE REPORT**

	LIBRARY	CONDUCT	AMBIENT	PREMIER	PIRETT	COOPER/DEBART
CODING			432.10	931.80		\$ 255.00
51 366.00R			482.20	922.10		1,988.00
21.380.00M			175.10	910.90		2,388.00
22.520.00R			922.50	910.20		2,253.00
22.591.00			1008.0	930.80		3,263.50
44.392.00B			329.10	928.80		2,281.00
22.220.00B			412.00	916.00		5,233.00
22.350.00B			922.00	924.00		4,283.00
			672.19	930.80		1,924.99
			511.30	912.00		353.00

The illustration shows a stack of documents with a top sheet titled 'EXPENSE REPORT'. The report features a table with columns for functional classifications (LIBRARY, CONDUCT, AMBIENT, PREMIER, PIRETT, COOPER/DEBART) and rows for various coding categories. Below the table, there are several small charts and graphs, including a bar chart with three bars of increasing height and a line graph with a single data point.

# Functional vs. Natural Classifications

## Functional Classifications

Categorize costs by major classes of program and support services. Program services relate to the organization's purpose and mission, while support services include management and general, fundraising, and membership development activities.

## Natural Classifications

Include descriptions such as salaries, rent, utilities, interest expense, and supplies - similar to general ledger titles for expenses used in commercial accounting.

# Expense Classification Framework



## Program Services

Activities for which the organization is chartered. Examples: education and research (universities), patient care and education (hospitals), labor negotiations and training (unions), child care (day care centers).



## Management and General

Administrative expenses including executive oversight, accounting, human resources, and general operational support not directly related to programs.



## Fundraising

Activities related to soliciting contributions, including donor cultivation, fundraising events, grant writing, and development operations.



## Membership Development

Activities to attract and retain members, including membership campaigns, member communications, and member services.

All expenses (except investment expenses) are reported as decreases in net assets without donor restrictions. Investment expenses are netted against investment returns and classified according to investment revenue requirements.

# Natural Expense Components

Natural expense components must be presented for each functional expense category, showing the relationship between functional and natural classifications.

Natural Classification	Program A	Program B	Management	Fundraising	Total
Salaries and benefits	\$425,000	\$310,000	\$180,000	\$95,000	\$1,010,000
Supplies	\$85,000	\$62,000	\$28,000	\$15,000	\$190,000
Professional fees	\$52,000	\$38,000	\$45,000	\$22,000	\$157,000
Occupancy	\$118,000	\$86,000	\$42,000	\$18,000	\$264,000
Depreciation	\$95,000	\$70,000	\$35,000	\$12,000	\$212,000
<b>Total Expenses</b>	<b>\$775,000</b>	<b>\$566,000</b>	<b>\$330,000</b>	<b>\$162,000</b>	<b>\$1,833,000</b>

Expenses attributable to multiple functions require allocation on a reasonable, consistently applied basis. Common allocation methods include square footage for occupancy and depreciation, and time and effort for salaries.

# Required Financial Statement Disclosures

## Liquidity and Availability of Resources

Not-for-profits must disclose how they manage their liquid resources to meet operating needs within one year.

### Qualitative Information Examples:

- The organization maintains a policy of structuring its financial assets to be available as general expenditures, liabilities, and other obligations come due.
- The board has designated \$200,000 of unrestricted net assets for future facility expansion, but these funds remain available for general use if needed.
- Endowment funds of \$500,000 are subject to spending rate limitations of 4% annually.

### Quantitative Information Examples:

Financial assets available within one year:	
Cash and cash equivalents	\$125,000
Accounts receivable	\$35,000
Board-designated funds available if needed	\$200,000
<b>Total financial assets available</b>	<b>\$360,000</b>
Less: Amounts not available for general expenditure:	
Donor-restricted for specific programs	\$(50,000)
<b>Financial assets available for general expenditure</b>	<b>\$310,000</b>

# Sample Statement of Cash Flows

## Hope Community Center

For the Year Ended December 31, 20XX

<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Change in net assets	\$42,000
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
- Depreciation	\$35,000
- (Increase) in accounts receivable	\$(8,000)
- (Increase) in grants receivable	\$(15,000)
- Decrease in prepaid expenses	\$2,000
- Increase in accounts payable	\$5,000
- Increase in accrued expenses	\$3,000
- Increase in deferred revenue	\$4,000
<b>Net cash provided by operating activities</b>	<b>\$68,000</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
- Purchase of equipment	\$(45,000)
- Purchase of investments	\$(25,000)
<b>Net cash used in investing activities</b>	<b>\$(70,000)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>	
- Proceeds from long-term debt	\$50,000
- Repayment of long-term debt	\$(15,000)
<b>Net cash provided by financing activities</b>	<b>\$35,000</b>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>\$33,000</b>
Cash and cash equivalents, beginning of year	\$92,000
<b>Cash and cash equivalents, end of year</b>	<b>\$125,000</b>