NFP Financial Statements

Authoritative Guidance: FASB ASC 958 - NFP Financial Statements

Financial reporting for not-for-profit (NFP) organizations is governed by specific accounting standards under U.S. Generally Accepted Accounting Principles (GAAP) to ensure transparency, maintain donor confidence, and achieve regulatory compliance. **FASB ASC 958 (Not-for-Profit Entities)** provides the primary guidance for how NFPs should prepare their financial statements. Unlike for-profit entities, NFPs focus on accountability rather than profitability, with each fund often being a self-balancing set of accounts that includes its own assets, liabilities, revenue, and expenses.

Core Concepts: Required Financial Statements

Under GAAP, NFPs are required to use **accrual-basis accounting** for the preparation of their financial statements. Accrual accounting recognizes revenues when earned and expenses when incurred. NFPs must prepare a full set of financial statements that parallel the three basic financial statements used by private businesses. These include:

- **Statement of Financial Position** (equivalent to a balance sheet).
- **Statement of Activities** (equivalent to an income statement).
- **Statement of Cash Flows**.

1. Statement of Financial Position

The Statement of Financial Position provides information about an NFP's assets, liabilities, and net assets at a specific point in time. A significant simplification introduced by **ASU 2016-14** changed how NFPs categorize their net assets. Previously, net assets were classified as unrestricted, temporarily restricted, or permanently restricted. The updated guidance simplifies this into two main classes:

- **Net assets with donor restrictions**: These funds include what were previously termed temporarily restricted (funds restricted to a particular use or time) and permanently restricted (funds that carry a permanent restriction, such as some endowments or scholarship funds). Donor-imposed restrictions can be satisfied by the passage of a defined period of time (time restriction) or by performing defined activities (purpose restriction). For example, a grant for a specific program or an individual contribution intended for a particular campaign would fall into this category. Endowment contributions, where only the income generated from the investment can be used while the principal remains intact, are also classified here.
- **Net assets without donor restrictions**: These funds are free from any external restrictions and are available for general use, often referred to as general operating or general support.

Proper delineation of these two classes on the balance sheet is crucial. Focusing on "net assets without donor restrictions" provides organizations with the most accurate picture of funds available for current operations and is important for analysis, planning, and decision-making. Failure to properly disaggregate net assets is a common financial reporting mistake.

2. Statement of Activities

The primary purpose of a Statement of Activities is to provide relevant information about the increase or decrease in an NFP's net assets during the period. It details the effects of transactions and other events that change the amount and nature of net assets, the relationships of these transactions, and how the NFP's resources are utilized in providing programs and services. This statement is considered the **income statement equivalent** for NFPs.

Key aspects of the Statement of Activities include:

- **Classification of revenues, expenses, gains, and losses**: These are classified using the two broad categories of net assets: "net assets with donor restrictions" and "net assets without donor restrictions". Revenues are reported as increases in net assets without donor restrictions unless limited by donor-imposed restrictions. Expenses are generally reported as decreases in net assets without donor restrictions, with the exception of investment expenses, which are netted against investment return.
- **Release from Restrictions**: As a donor's restrictions are satisfied (e.g., by the passage of time or performance of defined activities), a reclassification is made from the restricted component of net assets to the component without donor restrictions. This transfer is often shown as a "release from restrictions" line item. For multi-year grants, the full amount is recorded as income with donor restrictions in the year received, and portions are released annually as restrictions are met. Without proper separation of restricted dollars, an NFP's income statement could show inflated surpluses in year one and artificial deficits in subsequent years.
- **Functional Expense Reporting**: All NFPs are required to present expenses by both **natural classification** (e.g., salaries, rent, supplies) and **functional classification** (e.g., program, management, fundraising). This enhances transparency and comparability. NFPs should develop consistent allocation methodologies for shared costs and utilize accounting software to track and report expenses by function and nature.

Common mistakes related to the Statement of Activities include misclassifying contributions (as exchange transactions instead of contributions), misapplying the timing of revenue recognition (especially for conditional contributions), neglecting to record donor-imposed restrictions, and overstating endowment funds by including board-designated reserves.

3. Statement of Cash Flows

The Statement of Cash Flows provides information about a company's sources and uses of cash, categorized into three types of activities. For NFPs, the principles of reporting cash flows are primarily contained in **ASC 230, *Statement of Cash Flows***, with specific guidance for not-for-profit entities found in **ASC 958-230**. This statement is a primary financial statement and is required for each period an income statement (or statement of activities for NFPs) is presented.

The three categories of cash flow activities are:

- **Operating Activities**: These generally relate to the NFP's core mission and production or delivery of goods and services. Examples include cash collected from sales, interest received from investments (if not specific to investing activities), and payments for operating expenses.
- **Investing Activities**: These involve cash inflows and outflows related to the acquisition and disposal of long-term assets, such as property, plant, and equipment, or investments in other entities. For example, the purchase or sale of land would be an investing activity.
- **Financing Activities**: These involve cash inflows and outflows related to debt and equity transactions, including borrowing activities and distributions to owners (for for-profit entities) or repayments of debt. For NFPs, this would include proceeds from borrowing on a loan and payment of cash dividends (if applicable).

Recent accounting standards updates (ASUs) can affect cash flow presentation. For instance, ASU 2023-06 impacts disclosures for derivative instruments, ASU 2023-08 clarifies cash flow presentation for crypto assets, and ASU 2023-09 revises income tax paid disclosures. Non-cash investing and financing activities (e.g., issuing stock for land) are not reported on the face of the statement of cash flows but should be disclosed in supplementary information or a separate schedule. The FASB's Not-for-Profit Advisory Committee (NAC) continues to highlight the need for improved cash flow presentation for NFPs.

Other Important Reporting Considerations for NFPs:

- **Footnote Disclosures**: Footnotes are essential for understanding an organization's financials, and missing or vague disclosures (e.g., on related-party transactions, contingencies, or concentration risks) can be red flags. Using a comprehensive disclosure checklist is recommended.
- **Lease Accounting (ASC 842)**: This standard requires nearly all leases to be recorded on the balance sheet, impacting NFP liabilities and assets.
- **Consolidation**: NFPs that control other entities (e.g., supporting organizations or subsidiaries) may need to consolidate those entities to avoid material omissions in reporting.
- **Annual GAAP Compliance Review**: Given the evolving accounting standards, conducting an annual GAAP compliance check is vital to ensure financial reporting accuracy and adherence to current standards. This is particularly important for organizations with limited financial staff or high finance leadership turnover.

The American Institute of Certified Public Accountants (AICPA) works closely with the FASB through its Not-for-Profit Advisory Committee (NAC) to ensure that the NFP sector's perspectives are effectively communicated during the development of financial accounting and reporting standards. Ongoing discussions within the NAC include enhancing liquidity disclosures and requiring more detailed disaggregation of investment returns.