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Module 6 Nonprofit Accounting

PAD 501

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Nonprofit Accounting: Key and Unique Features

- Required reading: Textbook pp 448-466 (part of Chapter 11)
- Fund Accounting: Tracks financial resources in separate “funds” based on their source and intended use to ensure that money received for a specific purpose is spent only for that purpose.
- Donor Restrictions: Reflect the conditions or limitations donors place on their contributions — for example, funds restricted for scholarships, specific programs, or future periods.
- Interfund Transactions and Transfers: Represent the movement of money between different funds — such as loans, payments for services, or permanent transfers of resources.
- Unique Reporting Features: Nonprofits report net assets in categories such as unrestricted, temporarily restricted, and permanently restricted; they also recognize donated goods and services differently from for-profit entities.

Nonprofit organization financial statements

- Statement of Financial Position
  - Shows what the organization owns and owes, and the net assets that remain. This is the balance sheet.
  - Nonprofits don't separate assets and liabilities into "current" and "long-term" categories
- Statement of Activities
  - Reports revenues, support, and expenses to show how the organization's net assets changed over time.
  - Nonprofits don't measure profit
- Statement of Cash Flows
  - Explains how cash moves in and out of the organization through operating, investing, and financing activities.

Donor Restrictions

- Donor-imposed restrictions require nonprofits to use funds only for specific purposes, time periods, or activities.
- Fund accounting is used to track these restricted resources separately — like keeping money in different “pockets” for different uses.
- Restricted funds can’t be mixed with general operating funds. They are reported separately so stakeholders can see that donor intentions are honored.
- These restrictions are binding until the purpose is fulfilled or the time condition has passed. Once met, the funds are “released” into unrestricted net assets.

Net asset classifications

- Net assets are classified as:
  - Unrestricted – available for any organizational purpose.
  - Temporarily restricted – must be used for a specific purpose or within a certain time frame.
  - Permanently restricted – principal cannot be spent; only income or gains may be used (e.g., endowments).
- Self-imposed (by board) restrictions may also be shown for internal designations by management or the board. Self-imposed restrictions are not shown on financial statements

Examples of donor restrictions

- Temporarily Restricted Funds
  - Funds must be used for a specific purpose or within a set time period.
  - Examples:
  - A $50,000 grant restricted to building a new playground.
  - A donation to fund a special education program for the upcoming school year.
  - A gift that can only be spent after a certain date.

Examples of donor restrictions

- Permanently Restricted Funds (Endowments)
  - The principal cannot be spent — only the earnings or investment income may be used.
  - Examples:
  - An endowment to support annual student scholarships.
  - A donation that must remain invested to generate income for community programs.
- Unrestricted Funds
  - Available for general use — management or the board decides how to spend them.
  - Often used for daily operations, salaries, or program flexibility.

Revenues and Expenses in Nonprofit Accounting

- Revenues and Support:
  - Reported as increases in unrestricted net assets, unless subject to donor restrictions.
  - Includes contributions, grants, program service fees, and donated goods/services.
- Expenses:
  - Reported as decreases in unrestricted net assets.
  - Must be presented separately from revenues — netting is not permitted.
- Gains and Losses on Investments:
  - Reported as changes in unrestricted net assets, unless restricted by donors for a specific use.
- When Restrictions Expire:
  - Restricted funds are released and reclassified as unrestricted support.

Donated Goods and Services

- Nonprofits record donated goods and services at their fair market value at the time of donation.
  - Fair market value: the amount the organization would have paid for them at the time of the donation.
- Donated goods (e.g., equipment, supplies) are recognized as both revenue and asset contributions.
- Donated services are recorded as revenue and expense only if:
  - They create or enhance nonfinancial assets, or
  - They require specialized skills (e.g., legal, accounting, medical) that would normally be purchased if not donated.
- Recording these donations ensures the organization's financial statements fully reflect the value of all resources used to achieve its mission.

Examples of Donated Services

- Which of the following services would be recorded as both **support (revenue)** and **expense**? Why or why not?
  - A parent who volunteers to transport children to a school soccer match
    - Not donated services
  - A corporate CEO who makes fundraising calls
    - Not donated services
  - A plumber who installs a new gas stove
    - Not donated services
  - A plumber who volunteers to do plumbing repairs for the organization
    - **Yes.** Recognize as donated services. (Donation revenue goes up; service expense goes up)

Inter-fund Transactions

- Loan: One fund borrows money from another.
  - Borrower records a liability (Due to Other Fund).
  - Lender records an asset (Due from Other Fund).
- Sale of Services: One fund provides services to another.
  - Recorded as if the funds were separate entities.
  - Revenue for one fund and expense for the other.
- Transfer: One fund gives resources to another without repayment.
  - Recorded as “Transfer to” (–) and “Transfer from” (+) in the fund balance.
  - No assets or liabilities created — just a reallocation of fund resources.

Interfund Transactions: Borrowing

- Example: The Operating Fund borrows $1,000 from the Building Fund.

Fund	Assets	Liabilities	Net Assets
Operating Fund	Cash +$1,000	Due to Building Fund +$1,000	No Change
Building Fund	Cash -$1,000 Due from Operating Fund +$1,000	—	No Change

Interfund Transactions: sales

- When two internal funds engage in a purchase or sale, they record the transaction as revenue and expense.
- Example: The Health Organization System (HOS) contracts with its Nursing School Fund to provide $5,000 worth of continuing education for its nurse managers.

Fund	Assets	Liabilities	Net Assets
Nursing School Fund	+ $5,000 Cash	—	+ Tuition Revenue $5,000
HOS Operating Fund	– $5,000 Cash	—	– Tuition Expense $5,000

Interfund Transactions: transfers

- When two internal funds transfer resources permanently — with no repayment or exchange of services.
- Example: The government transfers $10,000 from the General Fund to the Debt Service Fund to make debt payments.

Fund	Assets	Liabilities	Net Assets
General Fund	– $10,000 Cash	—	– Transfer to Debt Service Fund $10,000
Debt Service Fund	+ $10,000 Cash	—	+ Transfer from General Fund $10,000

Summary of inter-fund transfers

Type of Transaction	Description	Recorded As	Effect on Each Fund
Borrowing	One fund temporarily loans cash or resources to another fund.	*Due to* (liability) and *Due from* (asset).	Borrower: +Cash, +Liability Lender: –Cash, +Asset
Sales of Services	One fund provides goods or services to another for a fee.	*Revenue* (provider) and *Expense* (purchaser).	Provider: +Revenue + Cash Purchaser: +Expense – Cash
Transfers	One fund permanently gives resources to another.	*Transfer to* (decrease in net assets) and *Transfer from* (increase in net assets).	Giving fund: –Cash, –Net Assets Receiving fund: +Cash, +Net Assets