

## Reading and understanding financial statements for NPOs

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Written By: Enkel  
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Not-for-Profit Executive Directors, operational leaders, and board members spend a lot of time thinking about financial statements and the story they tell about the organization's overall performance and success. In fact, accounting in a Not-for-Profit organization generally undergoes more rigour and can be more complicated to understand than the financial statements of for-profit entities.

Nonprofit and for-profit organizations have different objectives, funding sources, and reporting requirements, leading to variations in their financial statements. Nonprofits prioritize transparency about their mission-related activities and funding sources, while for-profit entities focus on profitability and returns to shareholders.

While many of the same concepts apply, NPO financial statements generally follow the Accounting Standards for Not-for-Profit organizations (ASNPO) which have some nuances and complexities that are important to understand.

### **Accounting Standards for Not-for-Profit Organizations (ASNPO)**

In Canada, not-for-profit organizations are required to follow specific accounting standards and frameworks when preparing their financial statements. The Accounting Standards for NPOs:

- Apply to Canadian NPOs and charities
- Provide a set of accounting principles/standards for Not-for-Profit organizations
- Provide guidance on how to recognize and measure expenses, revenues, assets and liabilities in the context of a Canadian NPO
- Prescribes the format for financial statements and includes the Statement of Financial Positions, Statement of Operations, Statement of Cash flows, and relevant note disclosures
- Given the unique nature in which NPOs generate revenue (grants, donations, restricted and unrestricted contributions), revenue recognition standards are detailed and can be complex in the not-for-profit world
- These standards can change or be amended at any time.

## Reading and understanding financial statements for NPOs

Below we'll discuss the core financial statements used by NPOs including what they are and how they're used.

### 1. Statement of Financial Position

A nonprofit statement of financial position (referred to as a balance sheet in a for-profit company) is a financial statement that provides a snapshot of an organization's financial position at a specific point in time. It shows the organization's assets, liabilities, and net assets (equity) as of the reporting date. This statement is a fundamental part of a nonprofit organization's financial reporting and helps stakeholders understand the organization's financial health and resources available for its mission-related activities.

#### How it differs for nonprofit organizations

The Statement of Financial Position includes assets, liabilities, and net assets and answers the basic questions; what do we own, what do we owe, and what is our value. The nonprofit statement of activities serves a different purpose than its for-profit counterpart. While it still summarizes revenues and expenses, its primary focus is on the organization's mission-related activities and its ability to fulfill its nonprofit objectives. It typically distinguishes between unrestricted, temporarily restricted, and permanently restricted revenues and expenses, reflecting donor restrictions on funds.

- It includes various revenue sources, such as donations, grants, program service fees, and possibly investment income. These revenues are categorized based on donor restrictions, with restrictions impacting how the funds can be used.
- It often categorizes expenses by their nature (e.g., program expenses, fundraising expenses, administrative expenses) rather than by function. This presentation provides transparency regarding how resources are allocated to fulfill the organization's mission.
- Net assets can be broken down into unrestricted net assets, temporarily restricted (often mandated by the board or in the organization's bylaws), or donor-imposed. (Donor imposed means that a donor has provided an asset, usually cash, that must be used for a specific purpose and is earmarked on the financial statements as such.)
- The net position of assets minus liabilities is equal to net assets.
- The Statement of Financial Position for a nonprofit organization often includes restricted funds, restricted bank accounts and deferred revenue.

#### How it's used

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The Statement of Financial Position helps stakeholders assess the nonprofit's financial stability, liquidity, and the value of its assets relative to its liabilities. It does not provide information about the organization's performance during the reporting period.

### 2. Statement of Operations

A nonprofit Statement of Operations, also known as a Statement of Activities (and referred to as the income statement in a for-profit company), is a financial statement that provides a summary of a nonprofit organization's revenues, expenses, gains, and losses for a specific period, typically a fiscal year (unlike the Statement of Financial Position that provides a snapshot of the organization's financial position at a specific point in time). This statement is a fundamental part of a nonprofit's financial reporting and is designed to show how the organization's resources were utilized to support its mission and achieve its objectives during that time frame.

#### How it differs for nonprofit organizations

While both for-profit and nonprofit organizations use statements of operations to communicate their financial performance, the key differences lie in their objectives, revenue sources, presentation of expenses, and the focus on mission-related activities for nonprofits. Nonprofit statements of operations are designed to provide transparency regarding the organization's commitment to its mission rather than its profitability for shareholders.

- The goal is not to earn "profit" but rather to properly allocate revenues and expenditures of the organization in accordance with funder restrictions, Canada Revenue agency policies and ASNPO.
- The bottom line of a nonprofit statement of operations is typically the change in net assets. This change may be positive (excess of revenue over expenses) or negative (deficit), but it's not referred to as "profit" because nonprofits don't aim to generate profits for distribution to owners or shareholders.
- Nonprofits may include additional disclosures related to donor restrictions, program impact, and the nature of their programs, providing stakeholders with a deeper understanding of how they allocate resources to fulfill their mission.
- Nonprofit organizations compare the Statement of Operations to the organization's Board approved budget.

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- The Statement of Operations for a nonprofit organization is often reported to the Board of Directors in a format that shows the activity by Program or restricted/unrestricted funds.

### How it's used

The Statement of Operations provides insights into the nonprofit's financial performance, including its ability to generate revenues, manage expenses, and fulfill its mission. It helps stakeholders understand whether the organization is operating with a surplus or deficit and how it is tracking against the organization's budget.

### 3. Statement of Cash Flows

A nonprofit statement of cash flows, also known as a cash flow statement, is a financial statement that provides information about how a nonprofit organization generates and uses cash during a specific period, typically a fiscal year. This statement is a crucial part of a nonprofit's financial reporting because it helps stakeholders understand the organization's liquidity, cash management, and sources and uses of cash. Unlike the statement of operations that focuses on the organization's performance and mission-related activities, the statement of cash flows concentrates on the organization's cash flows, liquidity, and financing activities.

### How it differs for nonprofit organizations

While both nonprofit and for-profit organizations use cash flow statements to report their cash inflows and outflows, the key differences lie in the main objectives, sources and uses of cash, and the specific categorization and emphasis on activities related to their missions or profit generation. The nonprofit statement of cash flows is oriented toward supporting the nonprofit's charitable mission, while the for-profit statement of cash flows is focused on profitability and returns to shareholders or owners.

- Nonprofit cash flows reflect how funds are used to support mission-related activities, cover operational costs, invest in assets, and possibly service debt. The focus is on utilizing cash to advance the nonprofit's charitable goals.
- Shows historical cash flows rather than future-looking or planned cash flows.
- Helps an organization keep track of their restricted vs. unrestricted cash flow.
- Some of a nonprofit's cash might be restricted and not as liquid as other cash sources.

### How it's used

The nonprofit statement of cash flows provides valuable insights into how the organization manages its cash resources and how it aligns its financial activities with its mission-related objectives. It helps

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stakeholders assess the organization's ability to meet its short-term obligations, invest in long-term goals, and maintain financial stability. It can often help to highlight problem spots in the organization.

### A word about revenue recognition

Revenue recognition is an accounting principle that prescribes how and when an organization earns revenue and presents that revenue in the financial statements. Revenue recognition for NPOs is different from revenue recognition for for-profit entities because NPOs have different sources of revenue and different goals for their financial activities.

Revenue recognition has broad implications for NPOs. Revenue recognition principles are very often not aligned with cash receipts and expenditures, which can create significant confusion for stakeholders. A lack of understanding of revenue recognition can lead an organization's management team to make the wrong decisions for the organization.

Section 4410 of the ASNPO on revenue recognition provides guidance on the recognition, measurement, presentation, and disclosure of revenue for NPOs, including contributions, grants, and donations.

Furthermore, revenue recognition, as it is prescribed in Section 4410 is the industry standard and funders will often use this standard to confirm the revenues of an NPO. This can lead to determining whether repayment of funds previously advanced may be required, or if further advances will be made, for example.

For a more detailed exploration of Revenue Recognition for Not-for-Profit Organizations, download this [eBook](#) provided by [Enkel](#).

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