Nonprofit Accounting Academy

To Understand Nonprofit Accounting – Start Here

If you want accounting to work for your organization, you first need to know the basics of how it works. Similar to playing a card game, you have to know the rules! So here are basic rules of nonprofit accounting.

Accounting is based on the balance sheet.

If you understand the basic concepts of the balance sheet, everything else in accounting will be so much easier. The balance sheet has three main parts:

Assets – things you own

Liabilities – debt you owe to others

Net assets – everything you own minus everything you owe; in other words the portion of assets not financed by debt. (For-profit accounting calls this equity.)

Helpful Organization
Balance Sheet
December 31, 2017

Assets	
Cash	$3,500
Contributions receivable	500
Property and equipment (net)	1,000
Total Assets	$5,000
Liabilities	
Accounts payable	$200
Credit card payable	400
Total Liabilities	600
Net Assets	
Unrestricted from prior years	4,300
Net income	100
Total net assets	4,400
Total liabilities and net assets	$5,000

Based on these relationships: Assets = Liabilities + Net Assets.

To the left is an example of a simple nonprofit organization balance sheet.

Each line of the report represents an account (or group of similar accounts) in the chart of accounts. Notice total assets of $5,000 equals total of liabilities and net assets, also $5,000.

The first rule of nonprofit accounting is the balance sheet always stays in balance!

What else do you notice about the above balance sheet? They have a good amount of cash compared to liabilities. In fact, they could easily pay off all their liabilities immediately.

Cash is always the first asset on the balance sheet.

Notice cash is the first asset listed. Cash is the most liquid and readily available asset so it is always listed first.

Net assets is like a cumulative financial scorecard.

Notice the two parts in the Net Assets section: an amount of $4,300 carrying forward from prior years and current year net income of $100. Net assets shows how much the organization has earned (or lost) since the first day it started. It's like a cumulative financial scorecard!

What about net income?

So where did the $100 of net income come from? If you guessed the profit & loss report, you are right.

The profit and loss report shows you revenues received and expenses incurred over a period of time, such as fiscal year-to-date. Revenue minus expenses is net income. Another way of looking at net income is that it's the change in net assets over a period of time.

Helpful Organization
Profit and Loss
Year Ended December 31, 2017

Revenue and support	
Contributions	$5,000
Local government grants	2,000
Gifts-in-kind	500
Program service fees	750
Special events, net	1,000
Total revenue and support	9,250
Expenses	
Payroll expenses	6,100
Professional services	1,100
Office expenses	500
Travel	700
Insurance	450
Other expenses	300
Total expenses	9,150
Net income	$100

Here is an example of a nonprofit profit and loss report:

Each line of the report represents an account (or group of similar accounts) in the chart of accounts. Notice the top part of the profit and loss report shows revenues while expenses are listed in the lower part. Revenues minus expenses is shown on the last line as net income.

The profit and loss report is the detail breakout of how the $100 of net income on the balance sheet was generated. With every revenue or expense transaction, net income will change and the balance sheet will update accordingly.

Every transaction affects at least two accounts.

By now you may realize that every transaction affects at least two accounts so the balance sheet stays in balance. For example, a cash gift will increase contributions on the profit and loss report which flows through to the balance sheet, increasing net assets. The other side of the contribution is an increase to cash. Since both net assets and cash are increased as a result of the contribution, the balance sheet stays in balance.

Likewise an expense paid in cash will reduce cash and also create an expense on the profit and loss report. The expense will reduce net income on the profit and loss report and flow through to reduce net assets on the balance sheet.

The profit and loss report resets itself to zero at the start of each new accounting year.

The profit and loss report records revenues and expenses for one year at a time. At the start of the new accounting year, which may be a calendar year or a fiscal year ending in a month other than December, the profit and loss report will reset to zero in every account. The net income or loss from the prior year will “close” to the prior years’ net assets on the balance sheet.

The accounting cycle begins anew, with the profit and loss report keeping track of revenues and expenses for a new year.

Now you have the basic accounting framework.

We have more detail to explore, but we wanted to give you the basic ground rules of accounting. If you have a framework for how the balance sheet and profit and loss report fit together, we think it will be much easier to learn more advanced accounting concepts. And we have so much more to show you!

