



A Guide to Nonprofit Accounting (for Non-Accountants)

By Nick Zarzycki on March 5, 2019

You probably didn't start a nonprofit organization to stare at spreadsheets and Google things like "how to record an in-kind donation."

But proper accounting (and the analysis it lets you do) is crucial to the survival of your organization.

Here, we'll go over the basics: how to set up a bookkeeping and accounting system for your nonprofit, how accounting for not-for-profits is different from for-profit accounting, and what to look out for when doing your taxes.

Nonprofit accounting: an overview

Every organization is different. But at the very minimum, most nonprofits will need to do the following to get their accounting system up and running:

- Find a nonprofit-friendly bookkeeping solution
- Find an accounting solution that can do fund accounting
- Open a separate bank account and start performing bank reconciliations
- Learn how to record in-kind donations
- Start making budgets
- Learn how to create and analyze financial statements

Bookkeeping for nonprofits

Most nonprofits elect some kind of **treasurer** or **financial officer** to manage all of the organization's finances. And that treasurer needs certain tools to do their job properly. Using a personal bank account and keeping a shoebox full of receipts isn't going to cut it.

Specifically, a treasurer needs the following tools:

- Accounting software, or some kind of journal system
- A dedicated bank account for the organization
- Some way of creating budgets
- Some way of producing accurate and reliable financial statements

In other words, they need a [bookkeeping system](#).

Find a nonprofit-friendly bookkeeping solution

The first step to setting up any good bookkeeping and accounting system is to begin recording all of your organization's financial transactions. To do that, you've got lots of options:

- You can record them in a physical [ledger](#).
- You could input them into nonprofit-friendly accounting software like [Aplos](#) or [Nonprofit Treasurer](#).
- You could use an Excel spreadsheet, like the one we've prepared for you [here](#).
- You can get a bookkeeping service with non-profit experience to do all of the inputting and number-crunching for you.

Regardless of which solution you end up using, it must let you do the following:

1. **Record and organize receipts** (i.e. donations, in-kind contributions, etc.)
2. **Record disbursements** (i.e. payouts from funds your nonprofit controls or expenditures it makes)
3. **Keep track of petty cash transactions, [accounts receivable](#), [accounts payable](#) and payroll**

Make sure you can do fund accounting

The solution you decide on should also allow you to do some form of **fund accounting**. This means instead of piling your money into one big “cash” account, you’ll need to distinguish between and track separate buckets of money.

This is important because nonprofits often have very specific rules around different funding sources. Large nonprofits like universities, for example, will sometimes have thousands of accounts—endowments, scholarships, capital projects funds, and operating funds—that have very different rules about how they’re supposed to be spent.

Open a separate bank account

Don’t use your personal bank account to receive, hold or disburse money for your nonprofit. Make sure all of your nonprofit’s transactions go through a dedicated

bank account. Ask your bank whether they offer business chequing accounts tailored to nonprofits.

Start reconciling your bank accounts

Once you've got a bookkeeping system and a bank account in place, you need some way of making sure the information in both of those systems lines up. A [bank reconciliation](#) helps you do just that.

When you reconcile your bank accounts, all you're doing is comparing each transaction from your bank statement with the ones you have in your books. We recommend doing a bank reconciliation at least once a month to make sure your books are up to date and accurate, to help track cash flow, to prevent fraud and to detect bank errors.

For more information about how to perform one, check out our [guide to bank reconciliations](#).

Start using purchase orders

Nonprofits have tight rules around what they can and can't spend money on. They need an organized system that makes sure purchases are ordered, budgeted for, and fulfilled properly from the get go.

A [purchase order](#) can help you do just that. A purchase order is a document sent from a purchaser to a vendor to confirm a specific purchase of goods or services, and are generally a great way to make sure you and your supplier are always on the same page. Once your vendor signs it, it's a binding contract that tells you exactly how much you ordered from your supplier, how much you paid, and when the supplier agreed to deliver your order.

Learn how to record in-kind donations

Let's say a lawyer volunteers three hours of her time to review a contract for your nonprofit. How should you record that "gift"?

In most cases, this will involve opening a separate income account in your books for in-kind donations and entering a receipt for the donation based on the donation's **fair market value**.

The IRS defines fair market value as what a “willing buyer would pay and a willing seller would accept for the property, when neither party is compelled to buy or sell, and both parties have reasonable knowledge of the relevant facts.”

In this case, you'd probably ask the lawyer what they would charge a client for the same services. If their standard hourly rate is \$100/hr, you'd record the three donated hours as an in-kind donation of \$300.

If the value of the donation is small (below \$5,000) the IRS will let you determine a donation's fair market value yourself, usually based how much comparable goods and services are selling on the market. If the value of the donation is over \$5,000, you should get the donation formally appraised by an expert.

Start making budgets

Most nonprofits operate based on some kind of annual operating **budget**. A good budget can act like a roadmap for a nonprofit, determining where and when the organization will deploy its resources, and whether it's on the right track financially.

A budget is a financial plan (usually covering one calendar year) written out as a long list with two main categories:

1. Expected income sources (including corporate contributions, in-kind donations, fundraising income, grant income, revenue from events, sales, etc.)
2. Expected expenses (including payroll expenses, contractor expenses, fundraising expenses, etc.)

Where exactly your income and expenses come from and how you group them in your budget will depend on the nature of your organization. An annual operating

budget for a university will be very different than a budget for a small local art gallery.

But in general, creating a budget involves four steps:

1. Determine what your nonprofit wants to achieve in the coming year
2. Develop realistic estimates for how much it will cost to achieve all of those goals
3. Estimate what your income sources for that year will be
4. Alter the budget to align expectations with reality

Nonprofit-friendly accounting software shouldn't just allow you to create professional-looking budgets. They should also let you track how your income and spending for the year compare to your budget goals.

For more information about how to create a budget, check out the National Council of Nonprofits guide to [Budgeting for Nonprofits](#).



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Financial statements for nonprofits

Once you've got a bookkeeping system in place, you need to start creating financial statements. Looking at these documents can tell you how much money you have, where your money is, and how it got there.

Most nonprofit-friendly accounting software like [QuickBooks Aplos](#) or [Nonprofit Treasurer](#) will allow you to generate financial statements automatically. Although it's possible to [manually generate](#) financial statements from your ledger or spreadsheet, it takes a ton of accounting knowledge and time to do it right. In most cases, it's better to let your accounting software or a bookkeeper take care of this step for you.

Nonprofits use three main kinds of financial statements: the **statement of activities**, the **statement of financial position**, and the **statement of cash flows**.

Statement of financial position

The statement of financial position is like the nonprofit version of the [balance sheet](#). Like the balance sheet, the statement of financial position gives a snapshot of your nonprofit's financials at a particular moment, showing you what you *own*, what you *owe*, and how much money is* left over*.

The difference between the balance sheet and the statement of financial position is that, because nonprofits don't technically have any owners, the statement of financial position doesn't have any equity on it. Instead, it has **net assets**.

Net assets are simply what's left of your nonprofit once you subtract all of its liabilities from all of its assets. Expressed in equation form:

$$\mathbf{Assets - Liabilities = Net Assets}$$

This is essentially the nonprofit accounting version of the balance sheet equation.

Let's look at a sample statement of financial position for a nonprofit:

World Impact Foundation
Statement of Financial Position
As of December 31, 2018

Statement of Financial Position	
ASSETS	
Cash and cash equivalents	\$2,050
Grants	\$2,000
Pledges Receivable	\$4,100
Equipment	\$900
Total assets	\$9,050
LIABILITIES	
Accounts payable	\$150
Long-term debt	\$2,000
Total liabilities	\$2,150
NET ASSETS	
Unrestricted net assets	\$5,000
Restricted net assets	\$1,900
Total net assets	\$6,900

Notice how there are two types of net assets: **unrestricted** and **restricted net assets**.

Unrestricted net assets are any funds your nonprofit has received from donors that have no rules or conditions attached to them, like a pure cash donation.

Restricted net assets are donations that have certain terms and restrictions attached, have special accounting procedures, and must be kept separate from other net assets.

Statement of activities

The statement of activities (also sometimes called the **operating statement**) is like the nonprofit version of the **income statement**. Like the income statement, it tells you how “profitable” your NFP was over a given period by showing your revenue, minus your expenses and losses.

One major difference between the statement of activities and the income statement is that instead of calculating net “profit,” the statement of activities calculates **changes in net assets**.

Let’s look at a sample statement of activities for a nonprofit:

World Impact Foundation Statement of Activities As of December 31, 2018

	Unrestricted	Restricted	Total
Revenues:			
Donations	\$10,250	\$2,200	
Fees	\$12,700	-	
Other	\$550	-	
Total revenues	\$23,500	\$2,200	\$25,700
Expenses:			
Fundraising Events	\$2,250	-	
Other Fundraising	\$5,200	-	
Management	\$4,900	-	

	Unrestricted	Restricted	Total
General	\$5,700	-	
Total expenses	\$18,050	-	\$18,050
Change in net assets	\$5,450	\$2,200	\$7,650

See how instead of calculating “net income,” the statement of activities calculates changes in net assets?

Notice also how the statement of activities is divided into two sections: **restricted** and **unrestricted**.

Just like the statement of financial position, the statement of activities keeps net assets that have conditions and stipulations attached to them separate from unrestricted funds.

Statement of cash flows

The statement of cash flows helps you track all of your organization’s cash. It’s essentially a list of how much cash your organization generated from three main sources: **operations**, **investing** and **financing**.

Let’s look at a sample statement of activities for a nonprofit:

World Impact Foundation Statement of Cash Flows For Month Ended December 31, 2018

Cash Flow from Operations	
Increase in net assets	\$2,100
Additions to Cash	\$750
Depreciation	\$350

Cash Flow from Operations	
Increase in Accounts Payable	\$1,200
Subtractions from Cash	
Increase in Accounts Receivable	(\$1,700)
Increase in inventory	(\$2,000)
Net Cash from Operations	\$700

Cash Flow from Investing	
Purchase of property and equipment	\$1,200
Net Cash from Operations	\$1,200

Cash Flow from Financing	
Proceeds from restricted contributions	\$2,700
Debt repayments	(\$3,200)
Net Cash from Operations	(\$500)

Total	
Net cash flow for month ending December 31, 2018:	\$1,400

If you've dealt with for-profit cash flow statements before, this should look very familiar.

Nonprofit cash flow statements will refer to "change in net assets" instead of "net income," and will sometimes list cash flows that are restricted to certain uses.

While for-profit cash flow statements will talk about sales, service fees and investment income, nonprofit cash flow statements will more often mention items

like **donor contributions, membership dues, program fees and fundraising proceeds** instead.

For the most part, however, cash flow statements for non and for-profits are very similar.

Taxes for nonprofits

Once you've got your bookkeeping system setup and have started generating financial statements, the final piece of the nonprofit accounting puzzle is getting your tax obligations straight.

Nonprofits are taxed differently than for-profit companies. For the most part, nonprofits can apply to the IRS to become exempt from federal taxes under **Section 501**.

Section 501

This is the part of the tax code that concerns charities, nonprofits, and religious organizations that are exempt from paying federal taxes to the IRS.

While **tax-exempt status** might be determined by the IRS and federal law, **nonprofit status** is determined by state law. Because of this, the IRS requires that you [obtain nonprofit status](#) from your state before applying for tax-exempt status.

After you've registered as a nonprofit with your state, the next step is to apply for tax-exempt status under Section 501.

The IRS has three applications for tax-exempt status:

- **Form 1023**, for exemption under **Section 501(c)(3)**—this applies to [“charitable, religious and educational organizations”](#)

- **Form 1024-A**, for exemption under **Section 501(c)(4)**—this applies to “[social welfare organizations](#)”
- **Form 1024**, for exemption under **Section 501(a)**—this applies to “[other nonprofit or tax-exempt organizations](#)”

The IRS provides [this handy questionnaire](#) to help you figure out exactly which parts of the tax code apply to your organization, and which form you’ll use to apply for tax-exempt status.

The IRS receives more than 70,000 applications for tax-exempt status every year, so be patient when submitting your application. If you don’t hear back from the IRS within 90 days, call [Customer Account Services](#) to check on its status.

If I qualify for tax-exempt status, do I still have to pay some taxes?

Just because your nonprofit qualifies as tax-exempt under Section 501 doesn’t mean that all of your donors’ contributions qualify as charitable deductions. And it doesn’t mean that all of the activities your nonprofit spends money on aren’t taxable. Tax-exempt nonprofit employees are still subject to employment taxes, and your nonprofit could still be subject to sales, real estate and other taxes depending on which state it’s based in.

To learn more about exactly which taxes your tax-exempt nonprofit might still be on the hook for, consult [IRS Publication 557](#), or better yet, consult with a nonprofit tax specialist. They’ll have experience helping organizations like yours minimize their tax bill and make sure you aren’t breaking any tax code rules.

Form 990

Most organizations exempt from income tax under section 501 are still required to file [Form 990](#) (or Form 990EZ, if they qualify), which discloses your nonprofit’s revenues, expenses and changes to net assets to the public. Looking up a nonprofit’s Form 990—using services like [Guidestar.org](#)—can tell you a lot about its financial state.

(Certain religious, political and foreign organizations are exempt from filing Form 990. Consult page 4 of the IRS's [instructions to Form 990](#) to learn more.)

Nonprofit vs for-profit accounting

	Nonprofits	For-profits
Primary financial statements	Statement of financial position Statement of activities Statement of cash flows	Balance sheet Income statement Statement of cash flows
Assets, net of liabilities	Net assets	Equity
Tax status	Tax-exempt, if approved by the IRS under Section 501	Subject to income taxes