

PRIVATE FOUNDATION

Financial Reporting Guide

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PREFACE

In the complex and evolving landscape of philanthropy, private foundations play a unique yet critical role in supporting charitable initiatives through grants and community-based programs. Despite managing substantial financial resources, private foundations are not subject to the same reporting standards as public charities. Unlike public charities, they are not required to undergo financial statement audits, limiting the level of accountability and transparency expected in nonprofit financial reporting. Their primary public disclosure requirement is the Internal Revenue Service (IRS) Form 990-PF, *Return of Private Foundation*, but the information presented in these filings can vary significantly based on accounting methodologies and preparer expertise.

A foundation's financial statement reporting requirements depend on various factors, including programmatic activities, investment strategies and key accounting policies. Foundations — ranging from small, family office-run to large institutional and corporate entities — often follow different financial reporting models, making it difficult to compare, assess and fully understand their financial position and impact.

This raises an important question: Can private foundation financial reporting be standardized to improve clarity and consistency?

The answer is yes.

Our *Private Foundation Financial Reporting Guide* (the Guide) provides a structured approach to financial reporting, designed to minimize inconsistencies among foundation managers, financial professionals and stakeholders.

The Private Foundation Services team at PKF O'Connor Davies has spent the last two decades providing accounting, assurance, tax and advisory services to the private foundation sector. This experience has positioned us as trusted advisors to more than 600 private foundations, guiding them through a range of financial and operational challenges.

KEY TAKEAWAYS

This Guide offers insights to help private foundations achieve:

- **Stronger Alignment with IRS Form 990-PF** – The Guide was structured to complement the IRS Form 990-PF, enabling foundations to enhance tax compliance through clear financial statements and notes.
- **Improved Tracking** – Foundations can better monitor quarterly excise tax payments and qualified distributions.
- **Simplified Financial Understanding** – Bookkeepers, accountants and other professionals with limited private foundation experience can quickly grasp key financial elements.
- **Enhanced Comparability** – Private foundations can more accurately evaluate their financial position, investment returns and expenses against their peers.

We encourage foundation trustees and directors to leverage this Guide to strengthen transparency and financial reporting. Share it with your administrator, accountant, attorney or bookkeeper. If you are a professional advisor, such as an accountant or attorney, share the Guide with your foundation clients.

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I. DEFINITION OF KEY TERMS

Before reading the sample statements and footnotes, five terms should be understood.

Generally Accepted Accounting Principles (GAAP): The accounting principles followed when preparing financial statements for publicly traded companies and many private companies in the United States. This uniform reporting system is based on GAAP, which serves as the foundation for this presentation. Some foundations, however, may choose to use another financial reporting system, such as the cash, modified-cash or tax basis of accounting. Foundations that adopt a cash or modified-cash basis of accounting can still use this financial reporting guide by disregarding the accrual-based categories of assets and liabilities on the statements of financial position that are not applicable. This includes accruals and estimates required by GAAP (e.g., investments at fair value, right-of-use assets, property and equipment with accumulated depreciation, prepaid expenses, taxes payable, grants payable, etc.).

Foundations adopting a reporting framework other than GAAP should do so for practical reasons, focusing on key elements of their financial position and the note disclosures most relevant to the foundation's trustees and financial statement users.

Grants and Programs: A subcategory of the foundation's program services function, which typically reports the grants awarded during the year (on a GAAP basis) or the grants paid (on cash basis). Other expenses that may be reported under the grants and programs category include professional fees, program consultants and certain travel expenses, all which directly relate to the foundation's grantmaking function.

Direct Charitable Activities (DCAs): Charitable activities, other than administering a grants program, carried out by the foundation itself rather than through a grant to a charity. Examples of DCAs include conducting in-house research and publishing the results, supporting the service of foundation staff on boards of other charitable organizations, running an art gallery, providing technical assistance to grantees or offering meeting space to local nonprofits. Expenditures for these activities can be counted toward the foundation's annual 5% payout requirement. DCA expenditures are distinct from grant-related expenses and additional recordkeeping is necessary.

Operations and Governance: The primary category within the foundation's supporting services function. This category should report all expenses not allocable to:

1. Programmatic services expenses
2. Direct investment expenses related to generating investment returns

Unlike a traditional 501(c)(3) organization exempt from income taxes classified as a public charity, which categorizes its supporting services expenses under a "management and general" category, private foundations require more board and trustee oversight to govern their grantmaking activities. Grantmaking, of course, is a foundation's primary operating activity and the purpose of its existence.

Program-Related Investments (PRIs): Investments made by a foundation to support charitable projects or activities that count toward the 5% payout requirement. Typically structured as loans, PRIs can also include equity investments or loan guarantees. The IRS defines a PRI as any investment that meets the following three criteria:

1. Its primary purpose is to further some aspect of the foundation's charitable mission.
2. The production of income or the appreciation of property is not a significant purpose (the PRI is structured to produce lower-than-market returns on a risk-adjusted basis).
3. It may not be used to support any lobbying or political campaign activities.

Note: Certain line items in the following sample financial statements may be interpreted differently by different foundations and some judgment is required.



II. SAMPLE FINANCIAL STATEMENTS

Statements of Financial Position

Statements of Activities

Statements of Functional Expenses

Statements of Cash Flows

Statements of Financial Position

December 31

	20XX	20XX
ASSETS		
Cash and cash equivalents	\$ -	\$ -
Prepaid expenses and other assets	-	-
Investments	-	-
Program-related investments	-	-
Right-of-use asset - operating lease	-	-
	<u>\$ -</u>	<u>\$ -</u>
LIABILITIES AND NET ASSETS		
Liabilities	\$ -	\$ -
Accounts payable and accrued expenses	-	-
Grants payable	-	-
Excise taxes payable	-	-
Lease liability	-	-
Deferred federal excise tax	-	-
Total liabilities	<u>-</u>	<u>-</u>
Net assets without donor restrictions	-	-
	<u>\$ -</u>	<u>\$ -</u>

Statements of Activities

Year Ended December 31

	20XX	20XX
REVENUE AND SUPPORT		
Interest and dividends	\$ -	\$ -
Net realized and unrealized gain (loss) on investments	-	-
Less: direct investment expenses	-	-
Net investment return	-	-
Contributions and support	-	-
Total revenue and support	-	-
GRANTS AND OPERATING EXPENSES		
Grants and programs	-	-
Operations and governance	-	-
Total grants and operating expenses	-	-
Change in net assets before other changes	-	-
OTHER CHANGES		
Federal excise and other taxes	-	-
Change in net assets	-	-
NET ASSETS WITHOUT DONOR RESTRICTIONS		
Beginning of year	-	-
End of year	\$ -	\$ -

Statements of Functional Expenses

Year Ended December 31

	20XX			20XX		
	Grants and Programs	Operations and Governance	Total	Grants and Programs	Operations and Governance	Total
Grants	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Salary and related expenses	-	-	-	-	-	-
Consultants	-	-	-	-	-	-
Professional fees	-	-	-	-	-	-
Occupancy	-	-	-	-	-	-
Travel, convenings and conferences	-	-	-	-	-	-
Office, software and miscellaneous expenses	-	-	-	-	-	-
Legal fees	-	-	-	-	-	-
Accounting and audit expenses	-	-	-	-	-	-
Insurance	-	-	-	-	-	-
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Statements of Cash Flows

Year Ended December 31

	20XX	20XX
CASH FLOWS FROM OPERATING ACTIVITIES		
Change in net assets	\$ -	\$ -
Adjustments to reconcile change in net assets to net cash from operating activities		
Unrealized (gain) loss on investments	-	-
Realized (gain) loss from sale of investments	-	-
Amortization of right-of-use asset - operating lease	-	-
Deferred federal excise tax	-	-
Net changes in operating assets and liabilities		
Prepaid expenses and other assets	-	-
Accounts payable and accrued expenses	-	-
Grants payable	-	-
Excise taxes payable	-	-
Lease payable	-	-
Net cash from operating activities	-	-
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	-	-
Proceeds from sale of investments	-	-
Net cash from investing activities	-	-
Net change in cash and cash equivalents	-	-
CASH AND CASH EQUIVALENTS		
Beginning of year	-	-
End of year	\$ -	\$ -
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Federal excise taxes paid	\$ -	\$ -



III. SAMPLE NOTES TO FINANCIAL STATEMENTS

1. Organization

XYZ Foundation (the Foundation) is a nonprofit organization *incorporated/organized* in *(enter state)* on *(enter date)* and is dedicated to the *(enter program/mission statement and description of the Foundation's grantmaking focus and direct charitable activities)*.

XYZ Foundation is a nonprofit organization exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code (the Code) and is a private foundation as defined in Section 509(a) of the Code.

Or (if a Private Operating Foundation)

XYZ Foundation is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the Code) and was determined to be a private operating foundation as defined in Section 4942(j)(3) of the Code. As a result, XYZ Foundation is subject to the applicable regulations governing private operating foundations, including (among others) an excise tax on its investment income.

2. Summary of Significant Accounting Policies

Basis of Presentation and Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, as well as disclosure of contingent assets and liabilities at the financial statement date. These estimates also impact the reported amounts of revenues and expenses during the reporting period. Consequently, actual results may differ from these estimates. Significant estimates made by management in preparing the financial statements include the fair value of alternative investments. Management believes the estimates used are reasonable and appropriate.

Or (if basis of accounting is other than U.S. GAAP)

The financial statements are prepared on the cash basis, modified for the valuation of investments at fair value. Under this basis, revenue and related assets are recognized when received rather than when earned and expenses are recognized when paid rather than when the obligations are incurred, except for the unrealized gain (loss) on investments. No provision for deferred excise tax on investment appreciation was made. Management has determined that the cash basis, as described above, is an acceptable basis for preparing the financial statements under the circumstances.

Net Asset Presentation

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. All net assets are without donor restrictions.

Cash and Cash Equivalents

The Foundation considers all highly liquid debt instruments purchased with maturities of three months or less to be cash equivalents, except for those managed by the investment manager as part of its long-term investment strategy.

Fair Value Measurements

The Foundation follows U.S. GAAP guidance on fair value measurements, which defines fair value and establishes a hierarchy for fair value measurements. This hierarchy is organized into three levels based on the input assumptions used in pricing assets.

- **Level 1** inputs have the highest reliability and are related to assets with unadjusted quoted prices in active markets.
- **Level 2** inputs relate to assets with other-than-quoted prices in active markets, including quoted prices for similar assets or liabilities or other observable market data.
- **Level 3** inputs are unobservable and are used when observable inputs are not available.

The level in the fair value hierarchy within which a fair value measurement falls is determined based on the lowest level input that is significant to the overall fair value measurement.

Pursuant to U.S. GAAP guidance, alternative investments whose fair value is measured using the net asset value (NAV) per share as a practical expedient are not categorized within the fair value hierarchy.

Investment Valuation and Income Recognition

Investments are carried at fair value. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis and dividends are recorded on the ex-dividend date. Realized gains and losses on the sale of investments are computed on the specific identification basis. Both realized and unrealized gains and losses are included in the determination of the change in net assets.

Investment Risks and Uncertainties

Alternative investments can consist of non-traditional, not readily marketable investments, such as offshore limited partnerships, venture capital funds, hedge funds, private equity funds and common funds. The underlying investments of such funds, whether invested in stock or other securities, may sometimes include investments that are publicly traded or are subject to resale restrictions.

Values determined by investment managers and general partners of underlying securities that are thinly traded or not traded in an active market may be based on historical cost, appraisals, a review of the investees' financial results, financial condition and prospects. They may also incorporate comparisons to similar companies for which quoted market prices are available or other estimates that require varying degrees of judgment.

Due to the uncertainty of these valuations, the estimated fair values may differ significantly from those that would be obtained if the investments were traded in a public market or liquidated. These differences could be material.

Investment Expenses

Investment expenses on the statements of activities consist of fees paid directly to the Foundation's investment managers and custodians.

Contributions and Promises to Give

Contributions received and written unconditional promises to give are recorded at net realizable value in the period received and are considered available for any use unless specifically restricted by the donor.

Leases

As of January 1, 20XX, the Foundation leases office space. The office lease is reflected as a right-of-use (ROU) asset and a lease liability in the consolidated statement of financial position. The ROU asset represents the right to use the underlying asset for the lease term and the lease liability represents the obligation to make lease payments over the lease term. The ROU asset and lease liability are recognized at the lease commencement date, based on the present value of future minimum lease payments. The Foundation does not report the ROU asset and lease liability for its short-term leases (12 months or less). Instead, the payments of those leases are reported as lease expenses on a straight-line basis over the lease term. The Foundation's lease agreement does not include any material residual value guarantees or restrictive covenants.

Grant Expenses

The Foundation recognizes grant expenses upon award of the grant, following board approval.

Functional Allocation of Expenses

The financial statements report on categories that are attributable to either grants or general management. Expenses are allocated on a reasonable and consistently applied basis. Most expenses can be directly identified as either grants or general management and are classified accordingly. Salary and related expenses for management and supervision of program service functions by function have been allocated based on estimates of time and effort, as determined by management of the Foundation.

Accounting for Uncertainty in Income Taxes

The Foundation recognizes the effect of income tax positions only if those positions are more likely than not to be sustained. Management has determined that there are no uncertain tax positions requiring financial statement recognition or disclosure. The Foundation is no longer subject to examinations by applicable taxing jurisdictions for periods prior to December 31, 20XX (*enter three years prior to year-end date*).

Subsequent Events Evaluation by Management

Management has evaluated subsequent events for disclosure and/or recognition in the financial statements through the date that the financial statements were available to be issued, which date is (*enter date financial statements were issued to primary users/public domain*).

3. Concentrations of Credit Risk

Financial instruments that may expose the Fund to concentrations of credit and market risk include cash and cash equivalents on deposit with financial institutions and investments. From time to time, cash and cash equivalents may exceed the Federal Deposit Insurance Corporation (FDIC) limit. The Fund does not believe there is significant risk of loss due to the failure of a financial institution. The investment portfolio is diversified by type of investments and industry concentrations so that no individual investment, investment advisor, investment manager or group of investments represents a significant concentration of credit risk.

4. Concentration of Revenue and Related-Party Transactions

The Foundation received XX% of its contributions during the year ended December 31, 20XX from the Foundation's founders, who currently serve as board chair and treasurer.

5. Investments

The Foundation's investments as of December 31 include those classified within the fair value hierarchy as well as those not included within the hierarchy (see note 2). These investments are as follows:

XYZ Foundation
Notes to Financial Statements
December 31, 20XX and 20XX

December 31, 20X2

	(Level 1)	(Level 2)	(Level 3)	Investments Measured at Net Asset Value (*)	Total
Government obligations	\$ -	\$ -	\$ -	\$ -	\$ -
Corporate fixed income	-	-	-	-	-
Equities	-	-	-	-	-
Hedge funds	-	-	-	-	-
Private equity	-	-	-	-	-
Total investments at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	-
Cash held for investments, at cost					-
Total investments					<u>\$ -</u>

December 31, 20X1

	(Level 1)	(Level 2)	(Level 3)	Investments Measured at Net Asset Value (*)	Total
Government obligations	\$ -	\$ -	\$ -	\$ -	\$ -
Corporate fixed income	-	-	-	-	-
Equities	-	-	-	-	-
Hedge funds	-	-	-	-	-
Private equity	-	-	-	-	-
Total investments at fair value	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	-
Cash held for investments, at cost					-
Total Investments					<u>\$ -</u>

*As discussed in note 2, all of the Foundation's investments valued at NAV are not categorized within the fair value hierarchy. There were no transfers into or out of any classes of the fair value hierarchy.

Total investments measured using NAV as a practical expedient, along with liquidity information for such alternative investments at December 31, 20XX is as follows:

	Alternative Investments	Unfunded Commitments	Redemption Frequency (If Currently Eligible)	Redemption Notice Pending**
Hedge funds (see "a" below)	\$ -	\$ -	Daily - Annually	1 - 365 days
Private equity (see "b" below)	-	-	Illiquid	
Total	<u>\$ -</u>	<u>\$ -</u>		

** The private equity investments are illiquid investments.

XYZ Foundation
Notes to Financial Statements
December 31, 20XX and 20XX

XX of the funds represented approximately XX% of the Foundation's total investment portfolio as of December 31, 20XX (enter current year-end date) and XX of the funds represented XX% as of December 31, 20XX (enter prior year-end date).

- a. This category includes investments in hedge funds that primarily invest both long and short in U.S. common stocks and mutual funds. The management of the respective hedge funds can shift investments from value to growth strategies, from small to large capitalization stocks and from a net long position to a net short position.
- b. This category includes private equity funds that invest primarily in opportunistic investments in operating and financial companies. These investments are illiquid with distributions only occurring upon the liquidation of the fund's underlying investments. Management has estimated that the underlying assets of the funds will be liquidated over three to 10 years.

6. Liquidity and Availability of Financial Assets

The Foundation's financial assets and resources available to meet cash needs for general expenditures within one year of the date of the statements of financial position are as follows as of December 31:

	20XX	20XX
Financial assets:		
Cash and cash equivalents	\$ -	\$ -
Program-related investments		
Investments	-	-
Total financial assets	-	-
Less amounts not available to be used within one year		
Illiquid alternative investments	-	-
Financial assets available to meet general		
Expenditures over the next 12 months	\$ -	\$ -

The Foundation monitors its cash needs and availability regularly. Operating expenses and overall grantmaking budgets are approved annually as part of the budgeting process. The Foundation approves grants throughout the year during six grants committee meetings. Based on these budgets and approvals, operating and grantmaking expenses are monitored and forecasted monthly. Investments are liquidated quarterly to fund these activities.

7. Federal Excise Tax

The Foundation is exempt from federal income taxes under Section 501(c)(3) and 509(a) of the Internal Revenue Code and is classified as a “private foundation.” The Foundation is subject to an excise tax of 1.39% on its net investment income, as defined for tax purposes.

Deferred taxes principally arise from the differences between the cost and fair value of investments. The Foundation provides for deferred federal excise tax at 1.39% on the net unrealized appreciation in the fair value of investments.

The Foundation’s investment in certain alternative investments gives rise to the potential for unrelated business income tax liabilities, taxed at general corporate rates.

8. Commitments

Leases

During 20XX, the Foundation terminated an existing lease agreement and executed a new agreement for the same office space. The new lease, amended on November XX, 20XX, maintains the initial expiration date of May XX, 20XX.

As of December 31, 20XX (enter current year-end date), the weighted-average remaining lease term for the Foundation’s operating lease was 29 months, with a weighted-average discount rate of X.XX%. The ROU asset as of December 31, 20XX was \$XXX,XXX and amortization of the ROU asset during 20XX was \$XXX,XXX. Cash paid for operating leases for the year ended December 31, 20XX was \$XXX,XXX.

Future maturities of lease liabilities are presented in the following table for the years ending December 31:

20XX	\$	-
20XX		-
Total undiscounted cash flows		-
Less present value discount		-
	<u>\$</u>	<u>-</u>

Grants Payable

Grants authorized and awarded but unpaid at year end are reported as liabilities and are expected to be paid within one year.

9. Program-Related Investments

Program-related investments can include loans made at or below-market interest rates, revolving credit agreements and private equity investments. These investments aim to achieve a social impact while providing market returns. At December 31, 20XX, mission-related investments consisted of the following:

Loans, at cost	\$	-
Revolving credit agreements, at cost		-
Private equity investment, at cost		-
	<u>\$</u>	<u>-</u>

Loans, at cost, consist of XX loan agreements ranging from \$XX,XXX to \$XXX,XXX with interest rates between X.X% and X.X%. The loans are uncollateralized and are expected to be repaid between 20XX and 20XX. There were no loan commitments outstanding as of December 31, 20XX. Loans are expected to be repaid as follows:

20XX	\$	-
20XX		-
20XX		-
20XX		-
20XX		-
20XX and thereafter		-
	<u>\$</u>	<u>-</u>

Private equity investments, at cost, consist of XX subscriptions for (insert description of the investment). The company shall make discretionary distributions of net cash proceeds attributable to payments of principal and interest from time to time. This investment is currently not redeemable.

10. Related-Party Transactions

The Foundation's investment assets are managed by an investment firm (the Firm), where the Foundation's treasurer is the founder. The Firm received fees of \$XXX,XXX and \$XXX,XXX during the years ended December 31, 20XX and 20XX, respectively.

* * * * *



Conclusion

While this Guide does not cover every financial statement transaction or disclosure a foundation may encounter — since each foundation has unique circumstances — it provides a solid baseline for understanding a foundation's financial position, activities and keynote disclosures.

Private Foundation Services

Since 1891, PKF O'Connor Davies has been committed to the nonprofit sector. Today, we work with more than 600 private foundations and nearly 4,000 nonprofit organizations.

We provide comprehensive accounting, assurance, tax and advisory services, along with in-depth internal control support. Our team also has extensive experience managing complex investment portfolios and diversified grantmaking activities.

Contact Us

We welcome the opportunity to answer any questions you may have related to this overview or other accounting, audit, tax or advisory matters for private foundations. Please call 212.286.2600 or email any of the Private Foundation Services team members below:

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