

Understanding Nonprofit Financial Statements

Presented by:

Amy O'Connor CPA, Senior Accountant & Business
Development Specialist

Contact info: 267-422-4954 or aoconnor@bookminders.com

Agenda

- Fiscal Board Responsibilities
 - Internal Controls
 - Questions Boards should ask
- Nonprofit Basics
- Financial Statement Overview
- Statement of Financial Activities
- Statement of Financial Position
- Net Asset Balance Report

Bookminders

- Outsourced accounting services – replacing the functionality of a part-time to full-time staff
- Nonprofit Organizations and Small Businesses
- Degreed, knowledgeable and professional staff
- Over twenty-five years of proven experience
- Pittsburgh / Philadelphia / Baltimore

Internal Controls

Basics

- Fiscal procedures to protect the assets of an organization and assure compliance with laws, regulations and policies
- Two Types – Depending on the size of the nonprofit can be performed by staff and/or board
 - Activity Level – specific in nature and at the detail level involving individuals who are directly responsible for fiscal transactions
 - Entity Level – higher level and should include board and/or management

Internal Controls

The goal is to have Segregation of Duties

- More than one person involved in an accounting process makes it more difficult to commit fraud
- Board is responsible to make sure that there is a segregation of duties

Internal Controls

Cash Receipts

- Activity Level:
 - Open funder remittance (cash or credit)
 - Completes batch processing and supporting documents for deposit
 - Make deposit
 - Review of contributions and agreements for donor restrictions
- Entity Level: Reconciles deposits with A/R or Donor system

Internal Controls

Expenses

- Activity Level:
 - Posts payments and reconciles balance sheet accounts
 - Verifies that expenses are appropriately documented & approved
 - Check signing – NO signature stamps
- Entity Level:
 - Review Cash disbursements & vendor lists
 - Approval thresholds for transactions over certain dollar amounts

Internal Controls

Petty Cash

- Avoid if possible
- If you must have, always:
 - Locked box
 - Cash plus Receipts = Set Amount
 - Expense report with receipts submitted for replenishment

Internal Controls

Bank Statements

- Activity Level:
 - Prepare bank reconciliations on a monthly basis
- Entity Level:
 - Open Bank Statements
 - Review returned checks for authenticity
 - Bank to include voided checks or copies

Internal Controls

Payroll

- Use a Payroll Service
 - Automated tax filing service helps to assure that impounded taxes can not be tampered with
- Activity Level:
 - Approval of payroll records prior to processing
 - Transmit information to payroll service
 - Post payroll activity in accounting system
- Entity Level: Receive payroll reports and review

Additional Entity Level Controls





- Review Financial Statements and budget to actual reports on a regular basis.
 - Questions for the board to ask:
 - Do we have a net income or net loss?
 - Are our key sources of income rising or falling? If they are falling, what are we doing?
 - Are our key expenses, especially salary and benefits, under control?
 - Is our cash flow projected to be adequate and is it reasonable?
- Regular Meetings with accounting / finance teams

Other Key Financial Questions

Other key financial questions nonprofit board members should ask:

- Do we have sufficient reserves? Has the board adopted a formal policy for the establishment of reserves?
- Is our financial plan consistent with our strategic plan?
- Is our staff satisfied and productive?
- Are we filing all required reporting documents on a timely basis?
- Are we fulfilling all of our legal obligations?

Nonprofit Basics

- Why we need Financial Statements
 - Management  Operational Decisions
 - Boards  Strategic Planning
 - Funders  Use of Funds
 - Auditors  GAAP Reporting

Nonprofit Basics

- What is GAAP
 - Generally Accepted Accounting Principles
 - Standards, conventions, and rules that accountants follow for recording, summarizing and preparing financial statements
 - Principles constitute preferred accounting treatment

Nonprofit Basics

- GAAP requires the use of the accrual method of accounting. If you wish to have an audit done under GAAP, you must use the accrual method of accounting.
- Accrual Basis
 - Income \implies Posted based on when funds are earned
 - Expenses \implies Posted based on when expenses are incurred
 - Note: Entries can be spread over multiple periods for appropriate distribution.

Audit Comment: Method of Accounting – The accompanying financial statements have been prepared using the accrual method of accounting.

Financial Terminology

Income Statement = Statement of Financial Activities

Balance Sheet = Statement of Financial Position

Retained Earnings Equity = Net Asset Balance

Contribution = Donation

Restriction = Limitation on donation

Financial Statement Overview

- Chart of Accounts
 - Listing of financial statement accounts
 - Designed based on reporting requirements

Think of the chart of accounts as an organization system, similar to file folders, with an account (a file folder) for each type of accounting information you want to track

Financial Statement Overview

- Transactions make up Financial Statements
 - Individual transactions reflect daily activity
(Revenue and Expenses)
 - Posted to accounts on the financial statements
(Chart of Accounts)

Statement of Financial Activities

- Reflects an organization's financial performance for a specific time period

$$\begin{array}{r} \text{Revenue} \\ - \text{Expenses} \\ \hline \text{Change in Net Assets} \end{array}$$

Statement of Financial Activities

	<u>Feb 15</u>	<u>YTD</u>
<u>Revenue and Other Support</u>		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	<u>350</u>	<u>1,000</u>
Total Revenue and Other Support	<u>7,850</u>	<u>41,000</u>
<u>Expenses</u>		
5000 · Payroll Expenses	2,600	23,900
5500 · Facility Expenses	500	6,000
6000 · Office Expenses	<u>3,795</u>	<u>9,500</u>
Total Expenses	<u>6,895</u>	<u>39,400</u>
Change in Net Assets	<u>955</u>	<u>1,600</u>

Statement of Financial Activities

	<u>Feb 15</u>	<u>YTD</u>
<u>Revenue and Other Support</u>		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	<u>350</u>	<u>1,000</u>
Total Revenue and Other Support	<u>7,850</u>	<u>41,000</u>

WHAT is Revenue?

HOW and WHEN should Revenue be Recognized?

Statement of Financial Activities

Revenue classifications

Net Assets without Donor Restriction

Contributions to be used
at the organization's discretion



Net Assets with Donor Restriction

Donor imposed restriction
removed by time or act

Donor imposed restriction that
requires that the initial funds
must remain unspent
(Endowment)

Statement of Financial Activities

Revenue Recognition Rules

Recognize when *Earned*

- In Kind Contribution
- Conditional Pledge
- Exchange Transactions
- Fee for Service
- Memberships

Recognize when *Notified*

- Donation / Contribution
- Unconditional Pledge

Statement of Financial Activities

In Kind Contributions

- Nonprofit organizations may receive income in the form of goods or services, rather than cash
- Non-cash donations of goods or assets should be recorded at the fair market value of the asset as of the date the asset was contributed
- Should be recognized as revenue and expense of the nonprofit organization when received

Statement of Financial Activities

Donated Services

- Donated services may be recognized only if the services:
 - Create or enhance a non-financial asset (e.g., land, building, equipment, furniture, inventory, etc.)
 - OR
 - Require specialized skills, are provided by individuals possessing those skills, and would need to be purchased if not provided by donation
-
- Services that meet these criteria should be recognized as revenue and expense of the nonprofit organization when received

Statement of Financial Activities

Conditional Pledge

- A contribution promised that includes a right of return/release AND a barrier (*not just a mere administrative requirement such as "submitting an annual report"*) – new accounting under FASB ASU 2018-08
- Revenue is not recognized until the barrier is overcome
- All conditional contributions will be disclosed in the notes to the financial statements rather than on the Statement of Financial Activities.

Statement of Financial Activities

Fees for Service

- Charges a predetermined price or fixed fee based on a specific set of criteria
- The fee must be below the “market rate” in order to adhere to legal and IRS considerations
- Revenue is recognized when the service is performed

Statement of Financial Activities

Membership / Dues

- 501c(3) – Charitable Organizations– Memberships
- 501c(6) – Business Leagues – Membership Fees
- 501c(10) – Fraternity with a charitable mission – Dues
- Deferred until paid AND until membership period starts
- Recognized evenly over the period of membership

Statement of Financial Activities

Contributions

- Voluntary, unconditional, nonreciprocal transfer of cash or assets to an organization
- The donor received **nothing** in exchange for the cash or assets
- Contributions principally include:
 - General Donations
 - Pledges
 - Grants that are unconditional and are nonreciprocal transactions (i.e. benefit someone other than the agency granting the funds)
- FASB 116 states that unconditional contributions must be recorded as revenue when the organization is notified that a promise to give has been made – not when the cash or asset is received

Statement of Financial Activities

Pledges

- A written promise to contribute cash or other assets to an entity, usually in the future. There must be sufficient evidence in the form of verifiable documentation that a promise was made.
 - Short Term – Expected to be received in under a year and recognized as Unrestricted
 - Long Term – Expected to be received between 1 - 5 years and recognized as Restricted for timing only
- FASB 116 states that unconditional pledges must be recorded as revenue when the organization is notified that a promise to give has been made – not when the cash or asset is received

Statement of Financial Activities

Grants

- Reciprocal transactions are exchange transactions – revenue recognized as earned
- Non-reciprocal transactions are contributions – if conditional, revenue is recorded when barrier is overcome – if unconditional, revenue is recorded when promise is made.

Statement of Financial Activities

<u>Expenses</u>	<u>Feb 15</u>	<u>YTD</u>
5000 · Payroll Expenses	2,600	23,900
5500 · Facility Expenses	500	6,000
6000 · Office Expenses	<u>3,795</u>	<u>9,500</u>
Total Expenses	<u>6,895</u>	<u>39,400</u>

WHAT are Expenses?

How and when are Expenses Recorded?

Statement of Financial Activities

Expenses

- Money spent or cost incurred in an organization's efforts to generate revenue, representing the cost of doing business
- Expenses may be in the form of:
 - Actual cash payments
 - A calculated expired portion (depreciation) of an asset
 - An amount taken out of earnings (such as bad debt)

Statement of Financial Activities

- Not-for-profit organizations are required to track expenses by account and by function.
- Functional categories include program, general and administrative and fundraising expenses.
- Most organizations have more than one program and each of these should be tracked separately.
- If an audit has been conducted, the audited statements will contain expenses on a functional level.

Statement of Financial Activities

Statement of Functional Expenses

- Classifies expenses into functional categories
- Program Services - fulfill the mission of the organization
- Support Services - anything that isn't program services (Fundraising and Administrative)

Statement of Financial Activities

Class Tracking within QuickBooks

- Class = a program or fund
- Produces a Statement of Financial Activity for each program / fund
- Subclasses can be used to organize groupings of classes
- Provides Net Asset Balances report for each program or fund.

Statement of Financial Activities

Class List

Support Service

Administrative

Fundraising

Programs

Headstart

Arts Program

Statement of Financial Activities

Statement of Activity by Class

	<u>Administrative</u>	<u>Fundraising</u>	<u>Programs</u>	<u>TOTAL</u>
<u>Revenue and Other Support</u>				
4000 · Contributions	-	9,000	6,000	15,000
4200 · Grants & Fees	-	-	25,000	25,000
4800 · Miscellaneous Income	1,000	-	-	1,000
Total Revenue and Other Support	<u>1,000</u>	<u>9,000</u>	<u>31,000</u>	<u>41,000</u>
<u>Expenses</u>				
5000 · Payroll Expenses	6,500	4,000	13,400	23,900
5500 · Facility Expenses	3,500	2,500	-	6,000
6000 · Office Expenses	5,000	1,250	3,250	9,500
Total Expenses	<u>15,000</u>	<u>7,750</u>	<u>16,650</u>	<u>39,400</u>
Change in Net Assets	<u>(14,000)</u>	<u>1,250</u>	<u>14,350</u>	<u>1,600</u>

= Statement of Functional Expenses

Statement of Financial Activities

Customer / Job Tracking within QuickBooks

- Used in addition to, not instead of, Class tracking
 - Customers = Revenue Classification
 - Jobs = Funding Sources
 - Classes = Programs
- A nonprofit with multiple funding sources needs to track expenditures across multiple programs
- Tracks activity that crosses fiscal years
- Net Asset Balance for each fund

Statement of Financial Activities

Job List

Net Assets without Donor Restriction

General - No Restriction

Allegheny County

Net Assets with Donor Restriction

McCune

Heinz

Statement of Financial Activities

Statement of Activity by Job (aka Funder)

	<u>General Funds</u>	<u>County</u>	<u>Grant</u>	<u>TOTAL</u>
<u>Revenue and Other Support</u>				
4000 · Contributions	15,000			15,000
4200 · Grants & Fees		15,000	10,000	25,000
4800 · Miscellaneous Income	1,000			1,000
Total Revenue and Other Support	<u>16,000</u>	<u>15,000</u>	<u>10,000</u>	<u>41,000</u>
<u>Expenses</u>				
5000 · Payroll Expenses	5,675	12,500	5,725	23,900
5500 · Facility Expenses	3,500	2,500	-	6,000
6000 · Office Expenses	8,500	-	1,000	9,500
Total Expenses	<u>17,675</u>	<u>15,000</u>	<u>6,725</u>	<u>39,400</u>
Change in Net Assets	<u>(1,675)</u>	<u>-</u>	<u>3,275</u>	<u>1,600</u>

Statement of Financial Activities

	<u>Feb 19</u>	<u>YTD</u>
<u>Revenue and Other Support</u>		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	<u>350</u>	<u>1,000</u>
Total Revenue and Other Support	<u>7,850</u>	<u>41,000</u>
<u>Expenses</u>		
5000 · Payroll Expenses	2,600	23,900
5500 · Facility Expenses	500	6,000
6000 · Office Expenses	<u>3,795</u>	<u>9,500</u>
Total Expenses	<u>6,895</u>	<u>39,400</u>
Change in Net Assets	<u>955</u>	<u>1,600</u>

Statement of Financial Activities

	<u>Mar 11</u>	<u>YTD</u>
Change in Net Assets	<u>955</u>	<u>1,600</u>

- Change in Net Assets = “Bottom Line”
- What happens to the Change in Net Assets?
- Where does it go?

Statement of Financial Position

- Change in Net Assets is reflected in the Net Asset Balance on the Statement of Financial Position

	<u>Feb 28, 2019</u>
<u>Assets</u>	
1000 · Cash	150,000
1200 · Accounts Receivable	10,000
1400 · Prepaid Expenses	3,795
1700 · Fixed Assets	45,000
1800 · Accumulated Depreciation	<u>(25,000)</u>
Total Assets	<u>183,795</u>
<u>Liabilities</u>	
2000 · Accounts Payable	30,500
2300 · Payroll Liabilities	500
2400 · Accrued Liabilities	10,000
2600 · Refundable Advances	46,000
2700 · Long Term Loans	<u>75,000</u>
Total Liabilities	<u>162,000</u>
<u>Net Assets</u>	
3900 · Net Assets	20,195
Change in Net Assets	<u>1,600</u>
Total Net Assets	<u>21,795</u>
Total Liab and Net Assets	<u>183,795</u>



Statement of Financial Position

Total Net Assets reflect an organization's cumulative financial position at any given point in time.

$$\begin{array}{r} \text{Assets} \\ - \text{Liabilities} \\ \hline \text{Total Net Assets / Net Worth} \end{array}$$

Statement of Financial Position

Feb 28, 2019

Assets

1000 · Cash	150,000
1200 · Accounts Receivable	10,000
1400 · Prepaid Expenses	3,795
1700 · Fixed Assets	45,000
1800 · Accumulated Depreciation	<u>(25,000)</u>
Total Assets	<u>183,795</u>

Any item of value owned
by the nonprofit that *could*
be converted to cash

Statement of Financial Position

Feb 28, 2019

Liabilities

2000 · Accounts Payable	30,500
2300 · Payroll Liabilities	500
2400 · Accrued Liabilities	10,000
2600 · Refundable Advances	46,000
2700 · Long Term Loans	<u>75,000</u>
Total Liabilities	<u>162,000</u>

An obligation that *could* result in the loss of an asset

Statement of Financial Position

Feb 28, 2019

Net Assets

3900 · Net Assets	20,195
Change in Net Assets	<u>1,600</u>
Total Net Assets	<u>21,795</u>
Total Liab and Net Assets	<u>183,795</u>

Net Assets are the “Equity” of an organization. They represent the unspent or overspent balance of funds provided.

Statement of Financial Position

QuickBooks

Assets	
Cash	150,000
Other Assets	13,795
Fixed Asset	20,000
Total Assets	183,795
Liabilities	
Payables	31,000
Other Liabilities	56,000
Loans	75,000
Total Liabilities	162,000
Net Assets	
3900 - Net Assets	20,195
Change in Net Assets	1,600
Total Net Assets	21,795
Total Liab and Net Assets	183,795

Audit Report

Assets	
Cash	150,000
Other Assets	13,795
Fixed Assets	20,000
Total Assets	183,795
Liabilities	
Payables	87,000
Other Liabilities	56,000
Loans	75,000
Total Liabilities	162,000
Net Assets	
Net Assets without Restriction	1,350
Net Assets with Restriction	20,445
Total Net Assets	21,795
Total Liab and Net Assets	183,795

Net Asset Balances

- What is the purpose of the Report?
 - Track over or under spending
 - Monitor Restricted funds
 - FASB Disclosure Requirement

Net Asset Balances Report (in QB)

QuickBooks

Audit Report

Net Assets without Donor Restriction

Admin 1,350
Allegheny Cty Contract 0

1,350

Net Assets with Donor Restriction

Pittsburgh Foundation 15,745
Heinz 4,700

20,445

Total Net Assets

21,795

Net Assets

Net Assets without Donor
Restriction

1,350

Net Assets with Donor
Restriction

20,445

Total Net Assets

21,795

Analyzing Financial Statements

- What Financial Statements Tell Us
 - Report financial performance
 - Evaluate financial resources
 - Measure efficiency
 - Monitor financial trends

Current Ratio

Does the organization have enough assets to meet its current liabilities?

$$\frac{\text{Current Assets} - \text{Restricted Cash}}{\text{Current Liabilities}}$$

The higher the ratio, the more liquid the organization. Generally, a healthy organization will have a current ratio of at least 1.

Make sure the accounts listed as current assets are collectible.

Restricted Asset Ratio

Are you borrowing from the future or from net assets intended for use in future periods?

$$\frac{\text{Cash + Accounts Receivable}}{\text{Net Assets with Donor Restriction}}$$

If this ratio is below one, the organization is borrowing from the future and doesn't have the money to perform promised actions.

Cash on Hand

How many days can the organization pay for expenses without receiving additional revenue?

$$\frac{\text{Total Checking / Savings}}{(\text{Total YTD Expenses} - \text{YTD Depreciation}) / \text{YTD Days}}$$

Organizations typically strive to maintain at least 90 – 180 days cash on hand. The high end is 2 years of budget. The low end is enough to cover 1 month of budget.

Functional Expense Allocation

What percentage of my expenses are spent on achieving the organization's mission?

$$\frac{\text{Program Service Exp.}}{\text{Total Expenses}} \text{ Vs. } \frac{\text{Fundraising Exp.}}{\text{Total Expenses}} \text{ Vs. } \frac{\text{Admin Exp.}}{\text{Total Expenses}}$$

It is reasonably expected that an organization should spend 70 – 80% of its resources on programs, 15 – 20% on administration and 5 – 10% on fundraising.

Review

- Board Fiscal Responsibilities
- Financial statements of a Nonprofit
- How net assets affect the balance sheet
- Using your financial statements to understand your organization

Bookminders Review Processes

- QA team reviews year-end package
- Year-end package sent to auditors includes:
 - QuickBooks file
 - Year-end reports exported to Excel
 - Bank Reconciliations
 - Grant letters, investment statements, and other supporting schedules
 - Executive Summary and Income Statement Analysis

Thanks for attending

Any questions?

Contact Information

Amy O'Connor

Senior Accountant & Business
Development Specialist

267-422-4954

aoconnor@bookminders.com



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