Understanding Nonprofit Accounting & Financial Reports

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Agenda

- Nonprofit Basics
- Financial Statements Overview
- Analyzing Financial Statements

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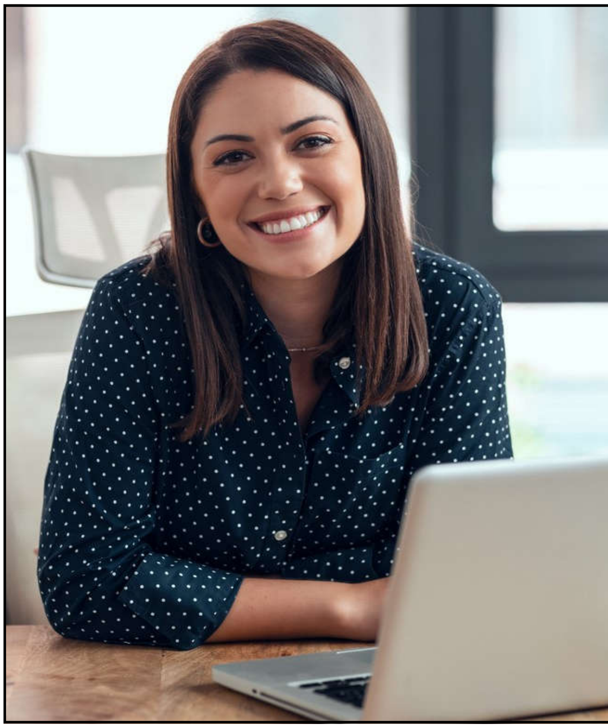

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- Outsourced accounting services: replacing the functionality of a part-time to full-time staff
- Nonprofit Organizations and Mid-Size Businesses
- Over 100 degreed, knowledgeable and professional staff
- 30+ years of proven experience
- Pittsburgh, Philadelphia, South Jersey, Eastern Maryland, Central Texas, and Indianapolis

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Nonprofit Basics

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Why we need Financial Statements

Management	→	Operational Decisions
Boards	→	Strategic Planning
Funders	→	Use of Funds
Auditors	→	GAAP Reporting

Nonprofit Basics

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Nonprofit Basics

What is GAAP?

- Generally Accepted Accounting Principles
  - Standards, conventions, and rules that accountants follow for recording, summarizing and preparing financial statements for all audits – not just nonprofit organizations
  - Principles constitute preferred accounting treatment
  - Important for organizations that require an audit

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Nonprofit Basics

Pennsylvania Filing Requirements (based on Annual Contributions)

- $750,000 or More: An independent Audit is required.
- $250,000 - $749,999: A Review or Audit is required.
- $100,000 - $249,999: A Compilation, Review, or Audit is required.
- $25,000 - $99,999: An Internally Prepared, Compiled, Reviewed, or Audited statement is acceptable.

***Important to note*: Other states that you are domiciled in or solicit funds in will have varying filing requirements you must follow.**

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Nonprofit Basics

Pennsylvania Department of State

Bureau of Corporations and Charitable Organizations

Charitable Registration Statement – BCO-10 Instructions:

- Initial registration – required prior to any compensated person soliciting contributions on behalf of the charitable organization or within 30 days of receiving $25K in gross contributions for those organizations that do not compensate any person for soliciting contributions.
- Annual renewal – refiled not later than 15th day of the 11th month following the close of the organization's fiscal year.

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Nonprofit Basics

IRS Filing Requirements (based on Gross Receipts):

- Form 990: Gross receipts greater than $200,000 OR Total assets greater than $500,000
- Form 990-EZ or 990: Gross receipts greater than $50,000 but less than $200,000 AND Total assets less than $500,000
- Form 990-N (postcard): Gross receipts normally less than or equal to $50,000.

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Nonprofit Basics

- "Single Audit"/ A-133 Audit
  - The OMB A-133 Compliance Supplement is a large and extensive United States federal government guide created by the Office of Management and Budget (OMB) and used in auditing federal assistance and federal grant programs, as well as their respective recipients.
  - Schedule of Expenditures of Federal Awards – "SEFA" – annual listing of all federal expenditures by funding source
- Thresholds:

  2025: A non-Federal entity that expends $1,000,000 (up from $750,000 this year before) or more during the non-Federal entity's fiscal year in Federal awards must have a single or program-specific audit conducted for that year

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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.

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

Accrual Method

- Income --> Posted based on when funds are earned
- Expenses --> Posted based on when expenses are incurred
  - Note: Entries can be spread over multiple periods for appropriate distribution

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Financial Statement Overview

Income Statement	=	Statement of Financial Activities
Balance Sheet	=	Statement of Financial Position
Retained Earnings Equity	=	Net Asset Balance
Contribution	=	Donation
Restriction	=	Limitation on Donation

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Statement of Financial Activities

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

Revenue

— Expenses

Change in Net Assets

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Statement of Financial Activities

	Feb 2024	YTD
Revenue and Other Support		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	350	1,000
Total Revenue and Other Support	7,850	41,000
Expenses		
5000 · Payroll Expenses	2,600	23,900
5500 · Facility Expenses	500	6,000
6000 · Office Expenses	3,795	9,500
Total Expenses	6,895	39,400
Change in Net Assets	955	1,600

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Statement of Financial Activities

	Feb 2024	YTD
Revenue and Other Support		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	350	1,000
Total Revenue and Other Support	7,850	41,000

WHAT is Revenue?

HOW and WHEN should Revenue be recognized?

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Statement of Financial Activities: Revenue Classifications

Net Assets without Donor Restriction

- Contributions to be used at the organization’s discretion
- Includes “Board Designated” Funds

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)

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Statement of Financial Activities: Revenue Recognition Rules

Recognized when *Earned*

- In Kind Contribution
- Conditional Contribution/Pledge
- Fee for Service
- Memberships

Recognize when *Notified*

- Donation
- Unconditional Pledge
- Grant

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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

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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

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Statement of Financial Activities: Conditional Contribution/Pledge

- A contribution promised that is dependent on the occurrence of a *future uncertain event*
- Revenue is not recognized until the barrier is overcome or condition is substantially met / reasonably expected to be met
- A condition is *not uncertain* if it is reasonably expected to occur

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Statement of Financial Activities: Fees for Service

- Charges a predetermined price or fixed fee based on a specific set of criteria
- Revenue is recognized when the service is performed

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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

GAAP requires 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

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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

GAAP requires 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

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Statement of Financial Activities: Grants

- Funds contributed by a foundation, corporation, or other funding source as a result of a grant proposal
- If a multi-year grant is awarded, GAAP requires recognition of the entire grant as revenue at the time the grant is awarded

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Statement of Financial Activities: Cost Reimbursement Grant

- A reimbursement grant provides funding to grant recipients
- Different scenarios on when funding is received but revenue is not recognized until earned
- Common when receiving grants from the government
- Revenue is recognized when the expenses have been incurred

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Statement of Financial Activities

Accurate Revenue Recognition helps ensure the following:

- Donor/Grantor Trust
- Compliance
- Audit-readiness

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Form 990 – Special Event Revenue

Special event revenue on Form 990 requires bifurcating gross receipts into contributions (the amount paid over the fair market value of goods/services provided) and sales (the fair market value of the goods/services). This must be reported in Part VIII (Revenue) and supported by Schedule G.

For example, if 200 tickets are sold at $200 each to a gala where the dinner and entertainment have a fair market value of $50:

- **Total Gross Proceeds:** 200 times $200 = $40,000
- **Charitable Contribution (Line 1c):** 200 times $150 = $30,000
- **Gross Sales (Line 8a):** 200 times $50 = $10,000

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Form 990 – Special Event Revenue

Revenue Presentation: Gross vs. Bifurcated

- **Under GAAP:** If the special event is an ongoing, major activity of your nonprofit, you generally present the revenue on your Statement of Activities as a single gross line item (e.g., "Special Event Revenue").
- **On Form 990:** You are forced to split (bifurcate) that same ticket revenue. The amount equal to the Fair Market Value (FMV) of the benefit goes to **Part VIII, Line 8a** (Gross Income). The remaining "premium" paid by the donor goes to **Part VIII, Line 1c** (Contributions).

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Form 990 – Special Event Revenue

Expense Treatment: Functional Categories vs. Direct Revenue Offsets

- **Under GAAP:** You have options, but most nonprofits report event costs (like venue rental or invitations) under "Fundraising Expenses" on the Statement of Functional Expenses. Alternatively, GAAP allows you to show the costs as a separate "Cost of Goods Provided to Donors" line.
- **On Form 990:** The IRS strictly commands you to take all *direct* donor benefits (like catering, food, and entertainment) and **subtract them directly from the event revenue** on Part VIII, Line 8b. They never make it to the Form 990 Statement of Functional Expenses (Part IX).

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Form 990 – In-Kind/Donated Services

Treatment of Donated Service

- **Under GAAP:** If a professional donates a service for your event (e.g., a pro-bono certified audio engineer sets up the stage), assuming it meets certain criteria, GAAP requires you to record the fair market value as both In-Kind Revenue and an In-Kind Expense.
- **On Form 990:** The IRS explicitly **prohibits** reporting donated services or the free use of facilities as revenue or expenses anywhere in Part VIII or Part IX.

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Form 990 vs. Financial Statements

Quick Comparison Table

Feature	U.S. GAAP Financials	IRS Form 990
Ticket Revenue	Reported as a **single gross line** item.	**Bifurcated** into contributions (1c) and gross sales (8a).
Direct Costs (Food/Drinks)	Listed under **Expenses** (Fundraising category).	**Netted directly against revenue** on Part VIII, Line 8b.
Donated Services	**Included** as revenue and expense if criteria are met.	**Excluded entirely** from revenue and expense sections.
Final Impact	High Total Revenue & High Total Expenses.	Lower Total Revenue & Lower Total Expenses.

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Form 990 vs. Financial Statements

- Because Form 990 nets out direct expenses on the revenue page, your Total Revenue (Line 12) and Total Expenses (Line 18) on the 990 will almost always be lower than your GAAP financial statements.
- Furthermore, shifting direct event costs away from your 990 Statement of Functional Expenses can alter your "Fundraising Efficiency" ratios on watchdog sites like Charity Navigator. This difference is bridged publicly using Schedule D, Parts XI and XII.
- Parts XI and XII are used by organizations that undergo an independent financial audit to reconcile the revenue and expenses reported on their audited financial statements with the revenue and expenses reported on their Form 990

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Statement of Financial Activities

	Feb 2024	YTD
Expenses		
5000 · Payroll Expenses	2,600	23,900
5500 · Facility Expenses	500	6,000
6000 · Office Expenses	3,795	9,500
Total Expenses	6,895	39,400

WHAT are Expenses?

HOW and WHEN are Expenses Recorded?

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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 or credit card charge
- A calculated expired portion (depreciation) of an asset
- An amount taken out of earnings (such as bad debt)

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- 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

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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)

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Statement of Financial Activities

Statement of Activity by Class

	Administrative	Fundraising	Programs	TOTAL
Revenue and Other Support				
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	1,000	9,000	31,000	41,000
Expenses				
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	15,000	7,750	16,650	39,400
Change in Net Assets	(14,000)	1,250	14,350	1,600

= Statement of Functional Expenses

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Statement of Financial Activities

	Feb 2024	YTD
Revenue and Other Support		
4000 · Contributions	4,500	15,000
4200 · Grants & Fees	3,000	25,000
4800 · Miscellaneous Income	350	1,000
Total Revenue and Other Support	7,850	41,000
Expenses		
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6000 · Office Expenses	3,795	9,500
Total Expenses	6,895	39,400
Change in Net Assets	955	1,600

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Statement of Financial Position

	Feb 29, 2024
Assets	
1000 · Cash	150,000
1200 · Accounts Receivable	10,000
1400 · Prepaid Expenses	3,795
1700 · Fixed Assets	45,000
1800 · Accumulated Depreciation	(25,000)
Total Assets	183,795
Liabilities	
2000 · Accounts Payable	30,500
2300 · Payroll Liabilities	500
2400 · Accrued Liabilities	10,000
2600 · Refundable Advances	46,000
2700 · Long Term 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

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

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Statement of Financial Position

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

Assets

— Liabilities

Total Net Assets / Net Worth

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Statement of Financial Position

	Feb 29, 2024
Assets	
1000 · Cash	150,000
1200 · Accounts Receivable	10,000
1400 · Prepaid Expenses	3,795
1700 · Fixed Assets	45,000
1800 · Accumulated Depreciation	(25,000)
Total Assets	183,795

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

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Statement of Financial Position

	Feb 29, 2024
Liabilities	
2000 · Accounts Payable	30,500
2300 · Payroll Liabilities	500
2400 · Accrued Liabilities	10,000
2600 · Refundable Advances	46,000
2700 · Long Term Loans	75,000
Total Liabilities	162,000

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

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Statement of Financial Position

	Feb 29, 2024
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

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

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Analyzing Financial Statements

Analyzing financial statements help us report financial performance, evaluate financial resources, measure organizational, and monitor financial trends.

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Functional Expense Allocation

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

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

- Reasonable allocation of organizational resources:
  - 70 – 80% programs
  - 15 – 20% administration
  - 5 – 10% fundraising.
- Highly subjective. Compare your organization to others similar in size and purpose.

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Current Ratio

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

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

- 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.

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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?

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

- 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.

Other Common Performance Indicators

Individuals served: Consider comparing the total number of individuals served to total program expenses and compare year to year or month to month.

Volunteer hours: Consider tracking and analyzing volunteer hours which indicates community engagement and operational leverage.

Donor retention rate: Track and review the percentage of donors from previous year who gave again this year.

Fundraising return on investment: Track and review the amount of money raised for every dollar spent on a campaign or event.

Average gift size: Calculate total contribution revenue divided by total number of gifts.

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Your Questions

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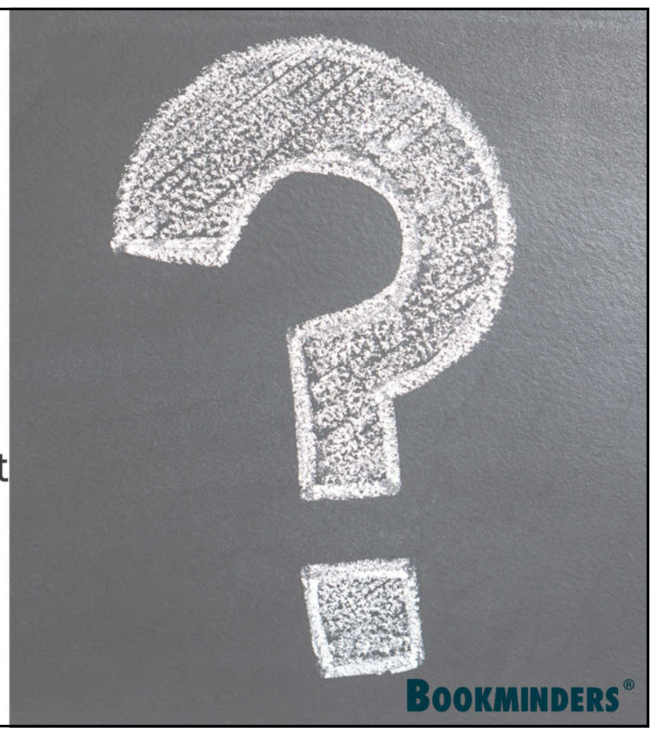

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