Understanding Nonprofit Financial Statements

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Seminar Outcomes

- To help you gain a better understanding of the unique aspects of nonprofit financial statements
- To help evaluate how you match up with your peers & your overall organization’s financial health
- To present the concept of 10 bottom lines of financial statement analysis
In General

• There are many different types of nonprofit organizations so presentations may vary based on unique circumstances of your organization.

• Differences may exist between internal and external financial statements.

• US Generally Accepted Accounting Principles (GAAP) apply including SFAS 116 & 117 along with other accounting industry standards.
Basic Nonprofit Financial Statements According to GAAP

• The Statement of Financial Position (Balance Sheet)
• The Statement of Activities (Income Statement)
• The Statement of Cash Flows
• Notes to Financial Statements
External Auditor’s Role

• Provide an ‘opinion’ on the US GAAP Basis Financial Statements. What does this mean?

• Report deficiencies in internal control over financial reporting. What are the auditors responsibilities?

• Report certain information to audit committees according to US Auditing Standards
Basic *Internal* Financial Statements

- May include:
  - Budget Analysis (Budget vs. Actual)
  - Departmental Cost Centers
  - Projections
  - Cash Flow Analysis
  - Analysis of Key Performance Indicators
  - Dashboard Reports
• The *keys* to assessing the overall financial health and managing risk:
  – Liquidity: How much cash do we have? Is our liquidity sufficient
  – Debt to Equity: sufficient cash flow to manage debt?
  – Reserves- How much?
Statement of Financial Position

- Receivables: Are they slow to collect? Aging?
- Payables: How fast are we paying our bills?
- Debt/Line of Credit: How is cash flow managed?
- Temporarily Restricted Net Assets: Do they best support core programs?
- Reserves: What is the nature? Are they suitable to the organization’s needs?
Statement of Financial Position

• Investments
• Marketable securities and debt instruments (stocks, bonds, mutual funds)
  – Recorded at Fair Market Value based on levels of input
    • Level 1
    • Level 2
    • Level 3
Statement of Financial Position

• **Net Assets**
  
  – *Unrestricted* – Assets which are not restricted either by donors or by law
    
    o Also includes board designated funds
  
  – *Temporarily Restricted* - Usage of is limited by donor-imposed time or purpose restrictions
  
  – *Permanently Restricted* – Assets which have been restricted by donor or law to be maintained by the organization in perpetuity
    
    o Endowment Funds
The Statement of Activities

• The *keys* to assessing the results of operations and sufficiency of current operating activity.
  – What is our bottom line?
  – How diverse is our revenue?
  – What are our major programs and do they align with our mission?
The Statement of Activities

• Revenue Recognition vs. Cash Collection

• Exchange Transaction vs. Contributions

• Should be presented in a manner that is useful to management and the board

• Variances should be analyzed
The Statement of Activities

• Other Items that maybe Unique to Nonprofit Organizations
  – In-kind or Donated Goods or Services
  – Statement of Functional Expense
  – Agency Transactions
The Statement of Cash Flows

- The *keys* to determining if cash flow is sufficient to meet current operations:
  - Is there cash flow from operations?
  - What is the nature of operating cash flows?
  - How are we investing our cash flows?
  - How are we financing operations?
The Statement of Cash Flows

**Effect on Cash Balance from All Activities**

- Reconciliation (bridge) from Accrual Basis Income to Cash
- Divided among the affect to cash balances from:
  - **Operational Activities**
  - **Investing Activities** (purchase/sale of investments or assets)
  - **Financing Activities** (payments for debts)
Ratio Analysis

• Monitoring & Evaluation of Performance
  – Assists with evaluation of performance
  – Quantify critical relationships behind the numbers
  – Guides the formulation of strategies
  – Enables comparison to industry peers

• Ratios assist the users of statements to derive meaning from the financial results of operations.
Ratio Analysis

- Selected Ratios:
  - **Current Ratio:**
    - Current Assets / Current Liabilities
  - **Reserve Ratio:**
    - Unrestricted Net Assets (excluding property and equipment) / Annual Budget
  - **Program Efficiency Ratio:**
    - Program Expenses / Total Expenses
  - **Administrative Cost Ratio:**
    - Administrative Expenses / Total Expenses
Benchmarking

• How do you compare to your peers?
  – Make sure your peer group is comparable.
  – Key performance indicators for your industry
  – US National Rating Bureaus
    o Guidestar
    o Charity Navigator
    o BBB Wise Giving Alliance
    o Charity Watch
  – Overhead myth
What are your current Financial Statements telling you?
Resources

- www.wegnercpas.com/non-profits/resources

- www.strongnonprofits.org

- http://overheadmyth.com/
Thank You!

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