

Demystifying Financial Statements of Not For Profit Organizations

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Types of Financial Statements

- **Audit**

Requires independent auditor to analyze and test transactions. Auditor must provide an opinion about the fairness, in all material respects, of the financial position of the organization.

Provides highest form of reliability.

Review

Independent auditor performs limited analytical review; there is no testing of transactions.

Compilation

Independent auditor converts management's internal financial information into a readable format. No opinion is expressed.

TYPES OF AUDIT OPINIONS

- **Unqualified:**

Clean Opinion

Qualified:

Statements present financial information fairly “except for” some limitation. If a major certainty exists, opinion “subject to” some outcome.

Adverse:

Statements “do not present fairly” the financial position. Generally due to departures from generally accepted accounting principles (GAAP).

Disclaimer:

No opinion issued due to restrictions on scope of audit work.

Turn to Page 1-2 of Audit Report and locate the auditor’s opinion of our financial statements.

Financial Statements

- **Statement of Financial Position**
- **Statement of Activities and Changes in Net Assets**
- **Statement of Functional Expenses**
- **Statement of Cash Flows**

Statement of Financial Position

- AKA.....The Balance Sheet
- Snapshot of a NFP's financial condition
- Reports on the Assets, Liabilities and Net Assets of the NFP at a given point in time (ex: June 30, 2009).

Turn to Page 3 of Audit Report and locate the Statement of Financial Position

What are Assets?

Things the Not For Profit Owns:

Cash:

Money held in operating checking and savings accounts

Accounts Receivable:

Money owed for services performed (ex: Contract with a city agency)

What are Assets?

Pledges Receivable:

Promises to Give by donors

Investments:

Fair value of money held in stocks, bonds, index funds

What are Assets?

- **Replacement Reserve:**

Money set aside to replace property, plant and equipment.

- **Land, Property, and Equipment:**

Cost of land, buildings, furniture, automobiles and operating equipment.

What are Liabilities?

Things the Not For Profit Owes:

Accounts Payable:

Money owed to third parties (vendors, government, etc.).

Accrued Expenses:

Money owed to third parties for goods provided or services performed but NFP has yet to receive an invoice.

What are Liabilities?

Deferred Revenue:

Money received by the NFP (ex: to perform services) but those services have not yet been performed.

Notes Payable:

Obligations to banks or other creditors based on formal written agreements.

What are Net Assets?

Net Assets = Assets – Liabilities

Types of Net Assets:

- **Unrestricted:**

Governing board has discretion as to how these funds can be used.

- **Temporarily Restricted:**

Donor has restricted the use of these funds [purpose and/or time] (ex: Impact 100 grant to an organization)

- **Permanently Restricted:**

Donor has imposed a restriction that does not expire by passage of time nor can it be fulfilled by actions of the organization (ex: Endowment)

Types of Unrestricted Net Assets

- **Board Designated:**

Board sets aside unrestricted net assets for non-operating activity (ex: future housing developments).

- **Capital:**

Unrestricted plant assets less plant-related liabilities.

- **Operations:**

Unrestricted Operating Assets less operating liabilities.

Statement of Activity and Changes in Net Assets

- AKA.....The Income Statement
- Reports how much the NFP earns (**Revenue and Gains**) and subtracts from that how much the NFP has spent (**Expenses and Losses**) **in a period of time** (ex: Fiscal Year Ending June 30, 2009).

Turn to page 4 of the Audit Report and locate the Statement of Activities

Revenue and Gains

Contracts, Government Funding:

Contracts the NFP has to provide services. Often called Exchange Transactions.

Contributions and Grants:

Individual, Foundation, Corporate donations. Donor receives no benefit from the contribution.

- Program Income and Fees:

Revenue from services provided (ex: tuition, rental income, food income). Usually paid by recipients of NFP's mission.

Revenue and Gains

- **Investment Income (loss):**

Interest Income, Dividends, Realized and Unrealized Gains and Losses.

- **Net Assets Released from Restriction**

Temporarily Restricted Revenue that becomes Unrestricted Revenue due to satisfaction of donor restriction [use and/or time] (ex: NFP received a donation to buy a car. Donation is temporarily restricted when made and then becomes unrestricted when car is purchased).

Operating Expenses

- **Program Expenses:**

Direct and Indirect Costs incurred to provide services associated with exempt purpose.

- **Management and General Expenses:**

Accounting, Human Resources, Executive Management.

- **Fundraising Expenses:**

Costs incurred to raise private funds to support the organization (ex: appeals, special events).

Statement of Functional Expenses

Provides additional information on how resources in the organization are used.

Statement breaks expenses down by function (ex: Housing and Support Services, Community Services) and by natural classification (ex: Salaries, Supplies, Communication)

Statement of Cash Flows

- Shows the amount of cash generated and used by the NFP in a given period.
- Breaks down activity into Operating, Investing and Financing Activities.

Myth #1

Not For Profit Organizations should not make profits.....

Reality

NFP organizations **must** grow their net assets (i.e. make a profit) to sustain future program activities, to hedge against inflation, and to provide a cushion in the event of the loss of future income or the occurrence of a one-time large unforeseen expense.

Unrestricted Net Assets represent the cumulative unrestricted profit earned by the organization from the date the organization began operations to the date of the Financial Statements.

NFPs do not distribute profits to owner's or shareholders.

Connecting the Dots...Connecting the Statements:

- 1) The Net Assets at the End of the Year reported on the Statement of Activities must equal the Net Assets on the Statement of Financial Position.

Example:

**Unrestricted Net Assets on Statement of Activities
(page 4) equals \$17,544,723**

**Total Unrestricted Net Assets on Statement of Financial
Position (page 3) equals \$17,544,723**

Connecting the Dots...Connecting the Statements:

- 2) The Change in Net Assets [i.e. profit or loss] reported on the Statement of Activities must equal the Change in Net Assets on the Statement of Financial Position

Example:

Change in Unrestricted Net Assets [i.e. Profit or Loss] from Statement of Activities (page 4) equals a loss of (\$260,251)

Net Assets on Statement of Financial Position (page 3)

2009	\$17,544,723
2008	\$17,804,974
Difference	<u>\$ (260,251)</u>

Connecting the Dots...Connecting the Statements:

Now you do it!

- What is the change in Temporarily Restricted Net Assets in 2009?
- Confirm that this number agrees to the Statement of Financial Position.

Connecting the Dots...Connecting the Statements:

Change in Temporarily Restricted Net Assets from Statement of Activities (page 4) equals \$1,133,259

Net Assets on Statement of Financial Position (page 3)

2009	\$10,370,900
2008	\$ 9,237,641
Difference	<u>\$ 1,133,259</u>

Note: Calculation is actually done for you on the Statement of Activities

Connecting the Dots...Connecting the Statements:

Now you do it!

Find the balance of Permanently Restricted Net Assets on both the Statement of Financial Position and the Statement of Activities.

How much did Permanently Restricted Net Assets increase or decrease in 2009?

What is the balance of Permanently Restricted Net Assets in 2009?

Connecting the Dots...Connecting the Statements:

Permanently Restricted Net Assets increased by \$262,094 in 2009 [page 4 - Permanently Restricted Column].

Balance of Permanently Restricted Net Assets on June 30, 2009 was \$6,692,295 [page 3 – Net Assets Section and Page 4 – Permanently Restricted Column].

Connecting the Dots...Connecting the Statements:

- 3) The total expenses on the Statement of Functional Expenses must agree to the total expenses on the Statement of Activities.

Example:

The total Operating Expenses on the Statement of Activities (page 4) equals \$12,276,702

The total Operating Expenses on the Statement of Functional Expenses (page 5) equals \$12,276,702

Connecting the Dots...Connecting the Statements:

Now you do it!

Locate Program Service Expenses on the Statement of Activities and then find the same number on the Statement of Functional Expenses.

How much were the total Program Services Expense in 2009?

How much of the Program Services Expense in 2009 were Salaries?

What were total Management and General Expenses in 2009?

Connecting the Dots...Connecting the Statements:

The total Program Services Expense in 2009 were \$9,487,895 [page 4 and page 5].

Of the total Program Expenses in 2009, \$4,762,829 were for Salaries [page 5].

The total Management and General Expenses in 2009 were \$2,142,670 [page 4 and page 5].

Myth #2

All Losses are the same.

Reality....They are not.....

<u>NFP 1</u>			
<u>Statement of Activities</u>			
	<u>UNR</u>	<u>TR</u>	<u>Total</u>
<u>Revenue:</u>			
Grants	\$ 5,000	\$ 20,000	\$ 25,000
Released from Restriction			\$ -
<u>Total Revenue</u>	\$ 5,000	\$ 20,000	\$ 25,000
<u>Total Expenses</u>	\$ 35,000	\$ -	\$ 35,000
<u>Changes in Net Assets</u>	\$ (30,000)	\$ 20,000	\$ (10,000)

<u>NFP 2</u>			
<u>Statement of Activities</u>			
	<u>UNR</u>	<u>TR</u>	<u>Total</u>
<u>Revenue:</u>			
Grants	\$ 5,000	\$ 20,000	\$ 25,000
Released from Restriction	\$ 35,000	\$ (35,000)	\$ -
<u>Total Revenue</u>	\$ 40,000	\$ (15,000)	\$ 25,000
<u>Total Expenses</u>	\$ 35,000	\$ -	\$ 35,000
<u>Changes in Net Assets</u>	\$ 5,000	\$ (15,000)	\$ (10,000)

Top 5 Things to Look for.....

- **Statement of Activities:**

- The changes in each Net Asset Category – Did the organization have a profit or a loss and which type of profit and loss (UNR, TR, PR)?
- Any significant change in amount and type of revenue?
- Any significant change in level and type of expenses?

Top 5 Things to Look for.....

- **Statement of Activities (cont'd):**

- How much did the organization spend on Program Costs vs. Management and General vs. Fundraising Expenses? Any significant change from prior year?

- What is the ratio of contributions and grants to fundraising expenses?

Top 5 Things to Look for.....

- **Statement of Financial Position**

- Does the organization have a positive unrestricted net asset balance?
- Has there been any significant changes in total net assets?
- How much unrestricted cash and cash equivalents (ex: Investments, Accounts Receivable) does the organization have? How does this compare to its current liabilities?

Top 5 Things to Look for.....

- Statement of Financial Position (cont'd)

- How much debt does the organization have and are they in a position to meet their debt obligations?
- Has the board designated any funds and if so for what purpose?

Don't Forget the Notes.....

- Learn about related parties
- Learn about the terms of the debt the organization is carrying
- Learn about the investment strategy of the organization
- Learn about the restrictions on the temporarily and permanently restricted net assets

Myth #3

Non-profits are where you go
when you want to retire.....

Reality...Bar Has Been Raised..... NFPs are doing more complex transactions

Project H.O.M.E.

People of Fortitude

Project HOME Limited Partnership
2826-28 Diamond Limited Partnership
2827-28 Diamond Limited Partnership
1440 North Broad Limited Partnership
1515 Fairmount Limited Partnership
1523 Fairmount Limited Partnership

People of Piety

1212 Ludlow Limited Partnership

People of Perseverance

1900 North Judson Limited Partnership

WOCCC Inc.

1929 Sansom Limited Partnership

2700 Diamond Development Corp.

1850 North Croskey Development Corp.

Project HOME Community Development Corp.

Where to Find out about a NFP....

- Guidestar –
www.guidestar.org
- Charity Navigator -
www.CharityNavigator.org
- PA Department of State – Bureau of Charitable Affairs
www.dos.state.pa.us/char/

Final Thoughts or Questions.....

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Questions

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