Financial Statement Boot Camp: How to read, understand, and use financial statements to run your nonprofit

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Presented to you by: CHARITY VILLAGE ENKEL

Speaker Bio

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[en-kel] Adjective | Simple

Co-founded by Omar Visram in 2016 with a simple problem in mind “*You can’t build a great organization without good books*”

- 300 Clients
- Worked with over 100 NPOs
- 80 team members with a global delivery model
- Focus on *Financial Operations* **<u>not</u>** advisory, tax and assurance work

Enkel would like to acknowledge that our offices are situated on the unceded traditional territories of the xʷməθkʷəy̓əm (Musqueam), Sḵwx̱wú7mesh (Squamish), and səlilwətaɬ (Tsleil-Waututh) Nations.


ACCOUNTS PAYABLE
PAYROLL
ACCOUNTS RECEIVABLE
BOOKKEEPING
CONTROLLERSHIP

Agenda

- Cash-based accounting versus accrual accounting.
- The core financial reports and how to use them.
- Revenue recognition and why it's important to NPOs.

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Polling Question:

Rate your ability to interpret/understand your financial statements from 0-10

(10 meaning you have a strong understanding)

Accounting can be hard, but…

- You don't need to be an accountant or a finance expert to understand financial statements, but it *is your responsibility* - especially if you are on the Board of Directors.

- The ED and Board of Directors should strive to acquire a basic understanding of finances and have the ability to interpret, assess and question the financial statements and other information.

- Turning to experts for help and advice is absolutely appropriate, but making financial decisions on behalf of the organization is the responsibility of every member of the board.

Welcome to Financial Statements Boot Camp!

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Why understanding your financial statements is important

- It’s the Board’s legal responsibility to ensure the organization is protecting assets, paying bills, compensating employees, and correctly managing revenues and donations.

- Donors and funders rely on you to manage and disburse funds they’ve entrusted to your organization with integrity and accountability.

- Your organization is subject to guidelines and policies that it must adhere to that directly affect how you report, manage and spend the funds entrusted to you.

- Interpreting the information presented to you is imperative to fulfilling these responsibilities.

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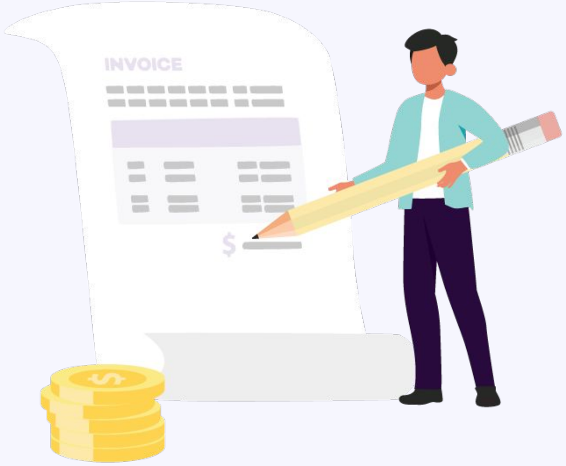

Cash Based vs.
Accrual Accounting

Cash Based vs. Accrual Accounting

The main difference between cash and accrual based accounting is in the timing of when revenue and expenses are recognized.

Let's start with an example:

You just received an invoice for Consulting Fees provided in August.
You want to record and pay it now (in October).

- **Cash based accounting** Record the invoice (expense) and payment in October even though the fees were incurred in August

- **Accrual accounting** Record the invoice (expense) in August when the expense was incurred. Then record the payment in October.

So why choose one over the other?

Cash Based vs. Accrual Accounting

Cash based accounting

- Simple/less complex
- Used most often by individuals and small businesses
- Statement of Operations aligns with cash flows in/out

Accrual accounting

- Follows generally accepted accounting principles
- Required for some organizations
- Provides a more accurate view of your organization’s financial performance
- Required for audits/reviews, or if requested by stakeholders
- More accurate picture of your organization's financial position and sustainability

Cash Based vs. Accrual Accounting

Sample NPO

Statement of Operations (Profit and Loss)

October to December 2023

	Cash Basis			
	Oct	**Nov**	**Dec**	**Total**
Revenue	$ 2,500.00	$ 11,450.00	$ 27,555.00	$ 41,505.00
Expense	$ (12,540.00)	$ (8,895.00)	$ (18,750.00)	$ (40,185.00)
Net Surplus/(Deficit)	(10,040.00)	2,555.00	8,805.00	1,320.00

	Accrual Basis			
	Oct	**Nov**	**Dec**	**Total**
Revenue	$ 15,000.00	$ 19,500.00	$ 16,550.00	$ 51,050.00
Expense	$ (12,540.00)	$ (15,750.00)	$ (14,400.00)	$ (42,690.00)
Net Surplus/(Deficit)	$ 2,460.00	$ 3,750.00	$ 2,150.00	$ 8,360.00

Cash Based vs. Accrual Accounting

While the cash basis of accounting is a simpler method, accrual basis accounting presents a more accurate picture of an organization's financial position and operating results because transactions are captured in real time in the period they occur.

Financial Statements

The most common financial statements presented to the Board of a non-profit

- Balance Sheet (Statement of Financial Position)
- Income Statement (aka. Profit & Loss, Statement of Operations)
    - with comparison to the budget and previous year
- Statement of Cash Flows

What is the Balance Sheet?
(Statement of Financial Position)

- A “snapshot picture” that indicates the organization’s financial position through assets, liabilities and net assets/liabilities (retained surplus/deficit)
- “Balanced” meaning: Assets = liabilities + retained surplus/deficit
- Bank accounts, investments, capital assets
- Prepaid expenses
- Deferred revenue/contributions and grant receivables
- Accrued expenses
- Shows the net assets/liabilities of the organization

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Sample Charity Inc.

Balance Sheet (Statement of Financial Position)

As of August 31, 2023

		Total
Assets		
Current Assets		
Cash and Cash Equivalents		
1001 Chequing Account		154,685.00
1002 Savings Account		84,548.00
1003 Restricted Cash		147,958.00
Total Cash and Cash Equivalent	$	387,191.00
1200 Accounts Receivable		54,255.00
1300 Prepaids		15,000.00
Total Current Assets	$	456,446.00
Non Current Assets		
1400 Long Term Investments		100,000.00
Property, plant and equipment		
1500 Computer Hardware		17,000.00
1510 Accum Dep. Computer Hardware		-5,800.00
1520 Furniture & Equipment		6,850.00
1530 Accum Dep Furniture & Equip		-3,200.00
Total Non Current assets	$	114,850.00
Total Assets		571,296.00

What the organization **OWNS**

SAMPLE Balance Sheet

(Assets Section)

SAMPLE Balance Sheet continued

(Liabilities + Net Assets Section)

Liabilities and Equity		
Liabilities		
Current Liabilities		
Accounts Payable (A/P)		
2110 Accounts Payable (A/P)		18,425.00
Total Accounts Payable (A/P)	$	18,425.00
Credit Cards		
2150 Credit card - AB		1,255.00
2152 Credit Card (CD)		58.00
2153 Credit Card (EF)		5,805.00
Total Credit Card	$	7,118.00
4220 Deferred Contributions		299,429.00
2310 GST/HST Payable		-7,500.00
2330 Payroll Liabilities		
2331 Vacation Pay		11,525.00
2334 WCB Payable		325.00
2333 EI/CPP Payable		798.00
Total 2330 Payroll Liabilities	$	12,648.00
4335 Accrued liabilities		15,000.00
Total Current Liabilities	$	345,120.00
Total Liabilities	$	345,120.00
Equity		
Retained Earnings		214,651.00
Profit for the year		11,525.00
Total Equity	$	226,176.00
Total Liabilities and Equity	$	571,296.00

What the organization **OWES**

Net Assets

What is asset amortization? Accumulated amortization?

- In the context of capital and intangible assets, amortization refers to the loss of value or consumption over a period of time

- Accumulated amortization is the accumulated balance of the amortization on the balance sheet that offsets the cost of the asset; The sum of the asset's cost and its accumulated amortization is its net book value

Example:

Charity 123 buys a computer for $4,000 on January 1, 2023.
It has an estimated useful life of four years. Year end is March 31.

Fiscal Year	Cost	Amortization (income statement)	Accumulated Amortization (balance sheet)	Net book value
2023	$4,000	$250	$250	$3,750
2024	$4,000	$1,000	$1,250	$2,750
2025	$4,000	$1,000	$2,250	$1,750
2026	$4,000	$1,000	$3,250	$750
2027	$4,000	$750	$4,000	$0

What happens in the financial statements from 2023 to 2027?

What could your balance sheet be telling you?

- If your liabilities exceed your assets, you may have a problem!
- You may not have sufficient assets to cover your obligations
- Timing is a factor
    - Short-term vs. long-term items - what needs to be settled in the current year? Which assets will convert to cash?
- If you have an excess of current assets, you may want to invest these in long-term assets to generate higher returns
- Can you improve the liquidity of your organization? Every organization is different. Can you?
    - Collect money faster?
    - Pay vendors slower?
    - Take on short-term financing to protect the organization against a liquidity problem

Income Statement
(Statement of Operations)

- Measures revenues and expenditures for a time period (e.g., 1 month, 1 year)
- Revenues - Expenses = Net Surplus/Deficit
- Revenues can come from donations, grants, government funding, membership fees, services provided, sales of merchandise, etc.
- Expenses from suppliers for merchandise, services or supplies
- Can be reported by Program (Class/Department)
- Should be compared to your organization’s budget approved by the Board

Sample Charity Statement of Operations (Profit and Loss) January to December 2022		
		Total
REVENUE		
4000 Program Revenue		
4105 Program Donations		23,500.00
4106 Program Foundation Grants		100,000.00
4114 Program Government Grants		355,000.00
Total 4000 Program Revenue	$	478,500.00
4600 Other Revenues		
4610 Unrestricted Donations		5,000.00
4615 Interest Revenue		1,350.00
Total 4600 Other Revenue	$	6,350.00
Total Income	$	484,850.00
Total Revenue	$	484,850.00
EXPENSES		
5000 Program Expenses		
5003 Program Materials		25,055.00
5004 Wages/Payroll Expenses		345,000.00
5005 Professional & Consulting Fees		12,000.00
5015 Honoraria		3,500.00
5020 Volunteer Appreciation		2,832.32
Total 5000 Program Expenses	$	382,055.00
5200 Other Expenses		
5201 Accounting & Audit		35,000.00
5202 Amortization		3,850.00
5203 Bank Charges		1,600.00
5204 Board of Directors		550.00
5205 Insurance		9,500.00
5206 Interest Expense		125.00
5209 Marketing & Communications		5,800.00
5210 Meals & Catering		310.00
5211 Meetings & Hospitality		1,250.00
5212 Memberships		500.00
5214 Office Supplies		1,600.00
5221 Rent/Occupancy Costs		15,000.00
5222 Software Subscriptions		450.00
5223 Staff Recognition		2,000.00
5226 Travel - Staff & Contractors		2,500.00
Total 5200 Other Expenses	$	80,035.00
Total Expenses	$	462,090.00
Net Surplus	$	22,760.00

SAMPLE Income Statement
(Statement of Operations)

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What could your statement of operations be telling you?

- Your progress relative to the budget set at the beginning of the year
- Trends in revenues and expenses compared to the previous year
- Expense categories that might be too high (relative to budget or as a percentage of overall expenses)
- Areas where you are underspending and may have an opportunity to create greater impact
- Gaps in revenue for the year relative to budget - could it be time to do a push for more donations?
- Unusual or one-time transactions
- Program revenues and expenses

Statement of Cash Flows

- Provides a close-up analysis of your organization's spending and fundraising trends
- Helps create a more accurate cash flow forecast
- Can uncover potential risks and opportunities regarding your organization's financial situation
- Measures the flow of cash in and out of the organization in the following categories:
    - Operating - Cash Flows from operating activities
    - Financing - Cash Flows from financing activities
    - Investing - Cash Flows from investing activities

Polling Question:

By reviewing your financial statements, can you identify the potential red flags that may create a risk to your nonprofit?

1. Recent rise in legal fees
2. Continuous deficiencies of revenues over expenses
3. Dependency on one revenue stream
4. Limited reserves
5. Excessive debt
6. All of the above

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6. **<u>All of the above</u>**

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Revenue Recognition

Revenue Recognition and why it's important to your NPO?

- Revenue for nonprofits can be derived from a number of sources including donations, funding, grants, fees for service, event ticket sales, grants, membership fees, sales of merchandise, and investment income.

- It's important to ensure that you are following guidelines related to your nonprofit (such as the guidelines outlined in the Accounting Standards for Non-Profit Organizations).

- You also want to ensure that revenue recognition aligns with your grant agreements and other obligations you have entered into.

Depending on the type of revenue, the recognition method can change. Let's look at some examples.

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Revenue Recognition examples (deferral method)

- Donations are recognized in the month they are received.
- Membership revenue is recognized equally during the period of the membership
- Grant revenue is often considered restricted revenue and recognized during the time period that the grant agreement spans and aligned with the expenditures incurred during a period of time.
- An unrestricted grant is recognized when received, much like a donation.
- Endowment funds are recognized directly in net assets when the organization is entitled to the funds.
- Capital contributions are recognized on the same basis as the amortization of the asset.

Your financial statements should be completed by an individual or team that understands the nonprofit sector.

In Conclusion

- Being able to understand, interpret and question financial statements is part of your responsibility as an Executive Director or member of the Board of Directors
- It is important to be able to identify any potential risks to your organization
- Accrual basis accounting provides the most accurate view of your organization's financial activities and sustainability
- Knowing how and when to recognize revenue is often required by your funder. ASNPO is usually the basis for preparation of the financial statements
- Revenue recognition depends on factors such as accounting policy choices, type of revenue and funder requirements
- Choosing your bookkeeping team wisely can ensure that your books align with the proper guidelines and principles for not-for-profit organizations.

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Interested in knowing what good monthly reporting looks like?

Book a free consultation with Omar!

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Questions?

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/Christine-kecser

Download our free guide:
[Financial Statements, Contribution Revenue Recognition, and Restricted Funds]

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