

## Quick Guide to Reviewing Nonprofit Financials

You can learn a lot about an organization by reviewing their financial information. The purpose of reviewing a potential grantee's nonprofit information is to understand their financial strength and stability and to know where their revenue comes from and how they use their funds.

Some organizations will be able to provide you with full financial information prepared by an external auditor. Audited financials can be relied on as accurate. Others will only provide you with their internal financial records and these may or may not be reliable. Either way, at a minimum, you should receive:

1. An **operating budget** for the current fiscal year
2. A **balance sheet** or **statement of financial position**
3. A **profit and loss** statement or **statement of activity**

### Reviewing an Operating Budget

An organization's operating budget is their plan for the revenue they will receive and the expenses they will incur over the course of a fiscal year. An organization may provide you with their operating budget in budget to actual form – meaning how their actual revenue and expenses line up against the predictions they made at the beginning of the year. If that is the case, pay attention to how the actual expenses and revenue compare to the organization's original plan. A budget-to-actual budget for the current fiscal year will only show actual expenses for the portion of the year that has already occurred and certain revenue streams or expenses may come early or late and the year and may not be evenly spread out over a twelve-month period.

Questions to consider:

1. Does the organization anticipate having sufficient revenue to cover all of their expenses?
2. Do they anticipate ending the year with a balanced budget, an operating surplus or an operating deficit? If they project a deficit, how will they pay for that deficit?
3. What are the organization's major expenses? Do they align with the organization's mission?

### Reviewing a Balance Sheet or Statement of Financial Position

An organization's balance sheet provides a snapshot of everything the organization owned and everything the organization owed at a given date in time, typically at the end of the organization's fiscal year. It does not show activity or change over time. Balance sheets list assets (what an organization owns), liabilities (what an organization owes, or debt) and provides a calculation of net assets (the difference between an organization's assets and liabilities).

$$\text{Assets} - \text{Liabilities} = \text{Net Assets}$$

Common assets for nonprofits include:

- Cash and cash equivalents – highly liquid funds
- Pledges or grants receivable – funds committed to the organization that are not yet received
- Prepaid expenses – costs paid in advance, like insurance
- Investments – the fair market value of stocks and bonds and other investments held by the organization on the date the financial statements were prepared (may be liquid or illiquid)
- Fixed assets or property and equipment – the value of land, buildings and equipment the organization owns

Common liabilities for nonprofits include:

- Accounts payable – unpaid bills, wages or taxes
- Grants payable – amounts promised to individuals or other organizations
- Line of credit – a revolving loan that the organization can draw from and pay back, usually to help resolve cash flow issues when expenses come earlier in the year than the revenue that will pay for them

- Due to third parties – funds due to other nonprofits (some organizations, like the Allied Jewish Federation or the United Way collect contributions on behalf of other nonprofits in the community)
- Long term debt – a bank loan, mortgage or other funds owed to a creditor

There are three kinds of net assets:

- Unrestricted – assets that an organization can use at their discretion (note: this can include non-liquid assets like property and equipment)
- Temporarily restricted – assets that must be used for a specific or time-limited purpose
- Permanently restricted – assets that will always be restricted for a specific purpose (like an endowment)

Questions to consider:

1. Do liquid assets (cash and cash equivalents) exceed current debts and accounts payable?
2. Do overall assets exceed liabilities?
3. How much debt does the organization have? Does it seem reasonable?

### **Reviewing a Profit and Loss Statement or Statement of Activity**

An organization's profit and loss statement provides an overview of revenues (resources received) and expenses (funds spent) for a period of time, typically a 12-month fiscal year.

$$\boxed{\text{Revenues} - \text{Expenses} = \text{Change in Net Assets}}$$

Common sources of revenue:

- Contributions – donations given or promised to an organization, can be unrestricted or restricted
- Grants – funds given or promised to an organization, can be restricted or unrestricted
- Program service fees – funds paid to the organization in exchange for a service they provide
- Special event revenue – funds raised at fundraising events
- Membership dues – annual payment from members to receive some form of service
- Investment income – income earned by dividends on stocks and/or interest on bonds, includes realized and unrealized gains/losses on investments

Common expenses:

- Program expenses – the costs associated with delivering programs
- Fundraising expenses – the costs associated with fundraising
- Administrative expenses – the costs of doing business, including record keeping, budgeting, finance and administration

Questions to consider:

1. Does the organization have diverse sources of funding including individual donations, corporate, foundation and/or government support, earned income, board contributions?
2. How much does the organization spend on fundraising activities and how much do they raise?
3. Did the organization have enough revenue to fully fund their operations or did they have a deficit? If they had a deficit, how did they pay for it and what are their plans to avoid having deficits in the future?
4. How does the profit and loss compare to the organization's budget for the current fiscal year?

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Sources:

Elizabeth K. Keating, "How to Assess Nonprofit Financial Performance," October 2001,

<http://www.austincc.edu/npo/library/documents/How%20to%20Assess%20Nonprofit%20Financial%20Performance.pdf>.

Susan Kenney Stevens, *All the Way to the Bank: Smart Money Management for Tomorrow's Nonprofits* (Larson Allen Weishair & Co LLP, 2nd edition, June 2002).

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