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Finance 101: Understanding Financial Statements

Non-Profit Collaborative

Free Seminar for Non-Profits

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FINANCIAL STATEMENT FUNDAMENTALS

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Why review financials?

- Monitor revenue, support and expenses, and compare results to prior periods or to budgeted amounts
- Assess the financial condition of the organization to determine if it is appropriate to expand or contract programs and services
- Determine whether additional fundraising events or activities are needed to fill the gaps from shortfalls in revenue
- Analyze the results of a particular program, activity or grant
- Determine management's ability to use funds effectively to meet the organization's mission

Monthly/Quarterly Financial Statement Reports

- Balance Sheet
- Income statement (Profit and loss statement/P&L)
- Statement of cash flows
- Budget versus actual report
- Detail versus summary reports
- Accounts receivable
- Accounts payable
- Custom reports

Annual Financial Reporting

- IRS Form 990
- Consolidated financial statements
- Compilations, Reviews and Audits

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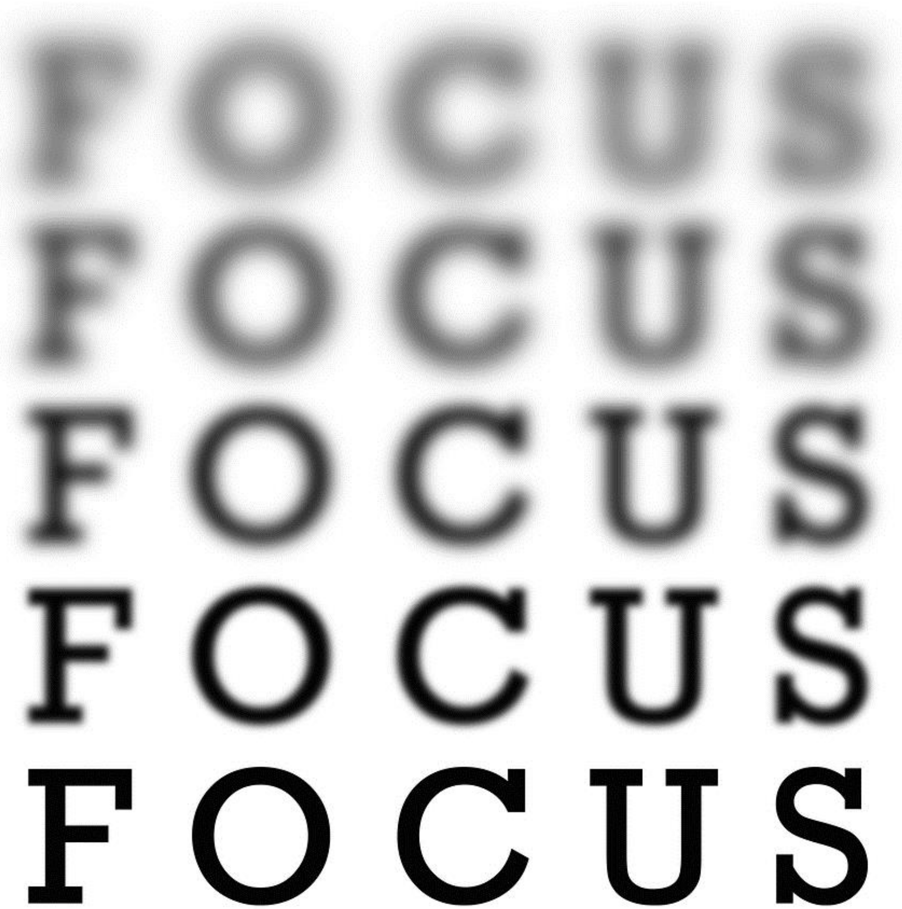
Financial Reporting

- The frequency of the reporting can be customized for each organization
- Typically the financials should be reviewed regularly as often as monthly/quarterly with the Executive Director, Board Treasurer, bookkeeper, Finance Committee
- The financial results should be shared at each board meeting with a high level explanation and justification for the results
- The full financials should be provided to each board member regardless of their role or expertise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Financial Statements are the Report Card of your Business or Organization

There are 5 major account categories:

Income	Expenses	Assets	Liabilities	Equity
Proceeds from sales	Costs of operation	What you own	What you owe	Net worth / level of investment

$\underbrace{\text{Income} \quad \text{Expenses}}_{\text{Operations}} \quad \underbrace{\text{Assets} \quad \text{Liabilities} \quad \text{Equity}}_{\text{Financial Position}}$

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Types of Account Categories

Income Accounts

Sales Revenue
Government Grants
Fundraising

Expense Accounts

Cost of Goods Sold
Rent Expense
Payroll
Marketing
Office Supplies

Asset Accounts

Cash Balances
Accounts Receivable
Inventory
Equipment
Real Estate

Liability Accounts

Accounts Payable
Credit Cards
Loans Payable

Equity Accounts

Owner's Equity
Retained Earnings
Net Worth

The Income Statement shows you:

- Money Coming in the Door (Revenue)
- Money Going out the Door (Expenses)
- What is left over (Income)

It is the Measurement of Profitability over a Period of Time

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Income Statement / Profit & Loss Statement (P&L)

- Shows the performance of your business over a period of time
- Resets at the beginning of each new accounting period (monthly, annually, etc.)
- Summarizes all revenue generated by the business
- Summarizes all expenses incurred by the business (by category)
- Calculates the net profit or loss, or "bottom line" = Income – Expenses
- Tells you how well your business is operated

My Company Income Statement
For the Month of March 2018

Income		
Sales Revenue	$	3,500
Expenses		
Payroll	$	750
Insurance	$	150
Rent	$	1,000
Utilities	$	150
Marketing	$	250
Total Expenses	$	2,300
Profit/Loss	**$**	**1,200**

Reviewing Your Income Statement

- How is your revenue trending?
  - Month-to-month
  - Against same period last year (considers seasonality)
- How are your expenses trending?
- What are your highest categories of expenses?
- Which expenses are fixed vs. variable?
- What is your cost of goods sold?
- Are you profitable?

The Balance Sheet provides a snapshot of:

- What is owned (Assets)
- What is owed (Liabilities)
- What is left over (Net Worth)

It shows the Wealth of the Organization at any Moment in Time

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Balance Sheet

- Shows a snapshot of your business at a point in time
- Accumulates over the lifetime and shows the net worth of the organization
- The Balance Sheet always Balances: ASSETS – LIABILITIES = EQUITY

My Company Balance Sheet
As of March 31, 2018

Assets			**Liabilities**		
Cash	$	5,000	Accounts Payable	$	900
Accounts Receivable	$	600	Loan Payable	$	3,500
Inventory	$	900			
Equipment	$	1,000	**Total Liabilities**	$	4,400
Total Assets	$	7,500	**Equity**		
			Retained Earnings	$	1,900
			Net Income	$	1,200
			Total Equity	$	3,100

Reviewing Your Balance Sheet

- Can your organization meet its payment obligations?
  - Cash balances
  - Working capital: Current Assets – Current Liabilities
- Cash Flow Management
  - How high is your accounts receivable balance?
  - How quickly are you collecting money owed to you?
- Debt Management
  - What are your total debt obligations
  - What is your total equity in the organization?

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Double Entry Accounting

- Every business transaction will affect at least two accounts
  - If only one side of the entry is done, the financial statements will be out of balance
- Example: You write a check to the newspaper for $100 to run an advertisement
  - Your cash account will be reduced by $100 (Balance Sheet)
  - Your marketing expense is increased by $100 (Income Statement)

Tying it all together:

To effectively analyze the performance of your organization, you should ask the three following questions:

1. How is the Organization doing versus Last Year
2. How is the Organization doing versus Competition
3. How is the Organization doing versus Budget

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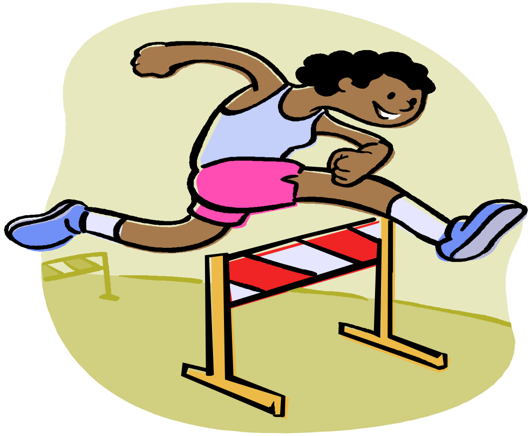
BUDGETING 101!

Your budget is the tool that will help you reach your goals!



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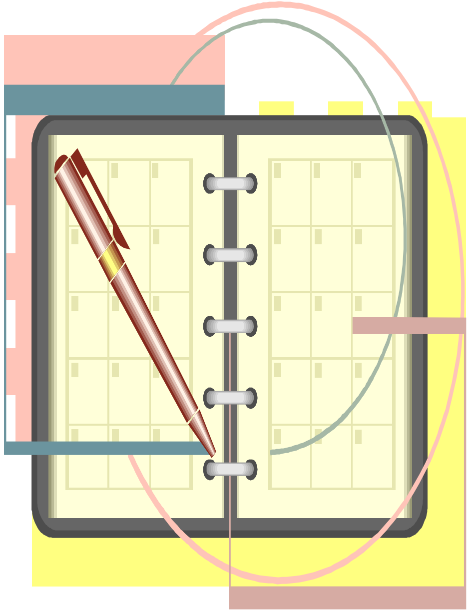
BUDGETS & FORECASTS WILL HELP YOU:

- Identify where the organization has been, where it is going, and how it will reach its goals.
- Define the organizations short and long term goals.
- Develop organizational objectives to be achieved during the year.
- Serves as a guide for month-to-month operations.

BUDGET PREPARATION

- Review Strategic Plan
- Review Prior financials – Typically a 2-5 year look back.
- Review income sources and opportunities for savings.
- Budget a net neutral or positive result!



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GATHERING DATA

- How secure are the funding sources?
- How many people benefit from the services?
- What does the service cost per person?
- How much revenue does it produce?
- Is the service readily fundable with grants?
- Does the organization rely heavily on one source of revenue such as donations?
- Should the budget contain a marketing campaign?

CASH FLOW

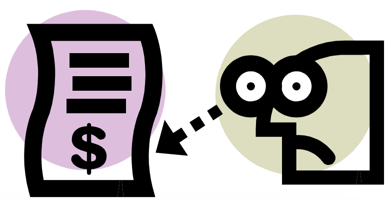
Cash flow should be projected, monitored and controlled.

Cash Flow refers to the need to have cash come in at the right times so that it is available as needed.

Careful attention should be paid to instances where income and expenses occur at different times.

A lack of cash to cover expenses is detrimental to the organization

- A cash forecast projects cash receipts and disbursements for each month of the year.
- Historical financial reports, experience, past budgets, and known future cash flow needs can help determine realistic estimates.
- Potential cash shortfalls should be identified as soon as possible to give ample time to plan the funding of the shortfall.



CAPITAL ADDITIONS

Beyond the operating budget the organization may need a capital budget for expected acquisitions of assets such as a building or new equipment.

In capital budgeting the following should be considered:

- Will the new asset improve performance and will it enable the organization to better accomplish its mission.
- Timing of the acquisition.
- How the acquisition will be financed.
- The costs to obtain and maintain the asset.

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Budgeting And Board Responsibility

- Review and approve the budget.
- Monitor the actual results to the budget on a monthly basis.
- Monitor the organization’s cash flow.
- Approve revisions to the budget as needed.

An accurate, complete, and current budget is the key to financial stability. A well thought out budget should be:

Realistic

Consistent

Flexible

Measurable

Financial Responsibility

Healthy non profit organizations employ financial management practices that build stability and flexibility both today and in the future.

Responsibility is shared throughout the organization and is supported with accurate information, frequent communication, and appropriate authority on the board level.

Transparency & Financial Integrity

The IRS, foundations, and donors demand information and answers about how nonprofits receive and use financial resources.

As public charities, nonprofits should expect to be held at a high standard of integrity and honesty in all financial activities.

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QUESTIONS

THANK YOU!