



Lesson 2:

3 Financial Statements to Know & Love

Can I Really Love a Financial Statement?

- ❑ Even if you are not the romantic sort, understanding financial statements can increase your confidence, spark insight, and help your team turn visions and dreams into reality.
- ❑ The *budget*, *income statement* and *balance sheet* say a lot about **how** an organization carries out its mission and puts its values into action.

Part A: The Budget

- ❑ A budget is a planning tool that translates your mission, goals and activities into numbers.
- ❑ A budget covers a period of time (such as the fiscal year).
- ❑ A budget shows the ways you plan to get money in (*revenue projection*), and how you will spend it (*expense projection*)

Example:

Can House of Hope Start a Parenting Group?

We at *House of Hope* want to start a new parenting group to support survivors of abuse.

We have a \$5,000 grant and can probably get food donated at a value of \$50/month. It costs \$500 per month to run the group (for simplicity's sake, we will not break down expenses today).

We want to run the group for at least 12 months.

Take a minute to sketch out a project budget, before you view the next slide.

Example – Income and Expenses

<u>Income</u>	
Grant	\$5,000
Food - in-kind donations, \$50/month x 12 months	\$600
<i>Total income</i>	<i>\$5,600</i>
<u>Expense</u>	
Group - costs \$500/month x 12 months	\$6,000
<i>Total expense</i>	<i>\$6,000</i>

- ❑ By listing each source of income and expenses into lines, we create *line items*.
- ❑ Income can be cash (a grant) and non-cash (food donation), which is called *in-kind*.

Example – The Bottom Line

- Do we have enough income to cover expenses?
Subtract expense from income:
 $\$5,600 - \$6,000 = (\$400)$
- The result is a *deficit* (also called *loss*) or a *surplus* (also called *profit*). This can also be called *net income*.
- Usually deficit or loss is represented in **red type** (literally, “in the red”) or in parentheses:
-\$400 is the same as \$400 and (\$400)
- *Balanced budget* is when income = expenses.

Example – Simple Project Budget

<u>Income</u>	
Grant	\$5,000
Food - in-kind donations, \$50/month x 12 months	\$600
<i>Total income</i>	<i>\$5,600</i>
<u>Expense</u>	
Group - costs \$500/month x 12 months	\$6,000
<i>Total expenses</i>	<i>\$6,000</i>
<hr/>	
<i>Surplus (Deficit)</i>	<i>(\$400)</i>

Uh oh, we do not have quite enough money to run the group without "operating at a loss." Time to raise more money, cut expenses, or dip into reserves!

Can Nonprofits Make a Profit?

Yes! Yes! Yes!

Accumulating savings, through budget surpluses, can be an important way for a nonprofit to ensure it can keep meeting the mission in the years to come.

For example, setting aside enough money for a rainy day helps the organization cope when the economy takes a nosedive. Of course, this should be balanced with the nonprofit's values and needs, such as spending enough today to continue programs, or paying staff fairly.

“Although charities do not exist to make money, they do work to build and maintain reasonable reserves of net assets. Growing its net assets helps a charity outpace inflation and sustain future program activities.” -Charity Navigator

Part B: Income Statements

An *income statement* (also called a *revenue & expense* report, or *profit & loss*) shows how the organization is actually getting and spending money, and compares that to what you had planned for the current fiscal year.

Most nonprofits look at income statements every month.

Example: Actual vs. Budget

Now let's assume we have run our new parenting group for 6 months (in a January – December fiscal year). How does our actual income and spending compare to our budget?

The columns compare how *House of Hope* is actually doing (*actual* or *Year to Date*) with its plans (*budget*), for that month or quarter and for the year so far.

Year to Date (*YTD*) means how much you have brought in or spent up in the current fiscal year, up to the date on the income statement.


Income Statement - June 30

Line items	Year to Date	Budget
INCOME		
Grant	5,000	5,000
Food in-kind donations	350	600
Total income	5,350	5,600
EXPENSES		
Group costs (staff, food, bus tickets, etc.)	3,148	6,000
Total expenses	3,148	6,000
Net surplus (deficit)	1,350	(400)

Percentage – Year to Date/Budget

- ❑ A quick way to see if we are on track is to divide the actual year to date by the budget for each line item, resulting in a percentage.
- ❑ Then we compare that % to how far along we are in the fiscal year.
- ❑ This is helpful mostly for regular monthly expenses (such as personnel or rent) and to keep focused on fundraising.

Income Statement – June 30 (excerpt)

Line Items	Year to Date	Budget	Percentage	Explanation
INCOME				Since this statement is dated June 30, or half-way through the fiscal year, we want to see at least 50% of expected income by now.
Grant	5,000	5,000	100%	The funder gave us all the money at the beginning of the year, so 100% of it is in.
Food <i>in-kind donations</i>	350	600	58%	We budgeted \$50/month, but the grocer was generous and gave us a little more. So instead of \$300 in-kind, we received \$350 so far.

Example – Income Statement

Here is what our parenting group income statement might look like:

Line items	Year to Date	Budget	Percentage	<i>Explanation</i>
INCOME				Since this statement is dated June 30, or half-way through the fiscal year, a normal percentage is 50%.
Grant	5,000	5,000	100%	The funder gave us all the money at the beginning of the year, so 100% of it is in.
Food in-kind donations	350	600	58%	We budgeted \$50/month, but the grocer was generous and gave us a little more. So instead of \$300 in-kind, we received \$350 so far.
Total income	5,350	5,600	95%	Wow, it is only 6 months into the fiscal year, and we already have 95% of income in.
EXPENSES				
Group costs (staff, food, bus tickets, etc.)	3,148	6,000	52%	Expenses are on track of our budget. (Time to go thank the parenting group staff!)
Total expenses	3,148	6,000	52%	Same as above.
Net surplus (deficit)	1,350	(400)		Right now our project is running at a surplus (yea!), but we could still end the fiscal year at a deficit (boo). You might ask staff if they can reduce spending by \$400, or try to cover more expenses through in-kind donations.

Part C: The Balance Sheet

Remember when we talked about *assets* and *liabilities* in Lesson 1?

A balance sheet gives a snapshot of:

- what the organization owns (*assets*),
- what it owes (*liabilities*),
- and the difference (*net assets* = assets - liabilities)

The balance sheet breaks down how much cash is on hand, money about to come in or go out, long-term debts, and the organization's net worth.

All this helps your team see the big picture.

Snapshot in Time

A balance sheet shows how the organization is doing from its **birth until now**, a single moment in time.

The balance sheet answers the questions, "Over the lifetime of this organization, what have we saved up? And what do we owe?"

Assets on a Balance Sheet

The first section of a balance sheet lists *Current Assets*. This means money, or things that could be sold or used up in the near future, usually within a year:

- ❑ cash in the bank
- ❑ short-term investments (such as certificates of deposit)
- ❑ inventory (if the organization earns income from sales)
- ❑ pre-paid expenses (such as annual insurance)
- ❑ *accounts receivable*

Accounts Receivable

Accounts receivable = what people owe you

This usually means invoices you have “billed out,” or sent to funders for payment.

Remember *accrual accounting*? Without the accrual method, you would not be able to see on paper what people owe your organization.

Long-Term Assets

The second thing listed on a balance sheet are long-term assets (also called fixed assets). This means things that have value but are harder to liquidate into cash.

Such as:

- ❑ land
- ❑ property (vehicles, buildings)
- ❑ major equipment.
- ❑ Sometimes called *property, plant & equipment*.

Depreciation

When property and equipment lose value as they age, their value *depreciates*.

This is the same idea as when a new car loses value as soon as you drive it off the sales lot. Equipment becomes outdated, buildings get worn down. So how do we reflect their changing value on the balance sheet?

Depreciation is an accounting principle that allows you to reduce an asset's value over time (usually several years), according to a set schedule.

Restricted Funds

Assets may be listed as *restricted*. This means money that you have received, but cannot spend yet, because the donor or funder has restricted its use.

Example: If your organization just received a full payment at the beginning of a 2-year grant, then the money for Year 2 of the grant may be “restricted.” You have the cash, but cannot spend some of it until next year. The balance sheet helps you keep track of this.

Example of Assets on a Balance Sheet

Let's revisit *House of Hope*.

Here is the top half of their balance sheet.

Balance Sheet (partial), June 30

ASSETS		<i>Explanation</i>
Cash and savings	50,000	Bank accounts
Accounts receivable	60,000	Invoices you have sent to funders or customers for them to pay you. Note this is not actual money in hand until they pay up!
Fixed assets	20,000	Land, buildings, vehicles, major equipment
Minus depreciation	(2,000)	This is how much the fixed assets (for example, a car) loses value every year. That prevents your organization from over-estimating their value.
Total Assets	128,000	This is the total value of everything the organization owns or has in money form.

Liabilities on the Balance Sheet

The next section on the balance sheet lists *liabilities*.

Current Liabilities are what you owe that must be paid fairly soon, usually within a year:

- ❑ Vacation pay due to employees
- ❑ Unpaid payroll taxes or salaries/wages, if any
- ❑ *Accounts payable*

Accounts Payable

Accounts Payable = payments due to others
(bills you have received, but not paid yet)

For example, you may open bills as they come in the mail, but your organization pays them twice a month. You enter these temporarily unpaid invoices into your accounting system as *accounts payable*. (This is important, for example, to track what your organization owes the IRS for payroll taxes!)

Long-Term Liabilities

Long-term liabilities = what you owe that is due over a long period of time, usually more than a year.

- ❑ Loans
- ❑ Mortgages
- ❑ Other long-term debts

Example of Liabilities on a Balance Sheet

Here is a list of liabilities that *House of Hope* owes, as of June 30. Notice that they have no long-term liabilities, or debts.

Balance Sheet (partial), June 30

Current Liabilities		
Accrued vacation pay	24,000	This is vacation pay that employees have saved up but not yet taken.
Accounts payable	6,000	These are bills the organization has received but not yet paid.
Total Liabilities	30,000	This totals up how much the organization owes to others.

Net Assets on a Balance Sheet

Net Assets = assets – liabilities, or what you own minus what you owe. Also called *equity* or net worth (a for-profit term). It is the accumulated savings of the organization over time.

- Hopefully this is a positive number!
- Let's think of net assets in the context of owning a car with a loan:
 - *Assets* = purchase value of car, minus how much value it has lost since you bought it (*depreciation*).
 - *Liabilities* = how much you owe the bank.
 - *Net Assets* = the amount of the car's value that you own, not the bank.

Types of Net Assets

- ❑ *Fund Balance* is retained earnings from the organization's birth until the end of the prior fiscal year
- ❑ *Excess (deficit)* is the current fiscal year's surplus or loss
- ❑ *Reserves* (see next slide)

Reserves

Many boards of directors set aside (or reserve) some net assets into *reserves* or *reserve funds*, to be spent only in certain situations.

This can be to save up for a special purpose (such as replacing the shelter roof) or it can be like burying money in a jar in the backyard (for a true emergency, such as an economic recession).

If a nonprofit does not set aside money for a rainy day, what happens when it rains?

Example of Figuring Net Assets

For House of Hope

Total Assets	\$128,000
<u>Total Liabilities</u>	<u>\$30,000</u>
Net Assets	\$98,000

And therefore,

Assets = Liabilities + Net Assets

\$128,000 = \$30,000 + \$98,000

The Balance in Balance Sheets

Balance sheets are usually arranged in two sections.

- The first section is Assets.
- The second section are Liabilities & Net Assets **listed together**.

The total of each section must be the same, or “balance.” This can be confusing, but makes sense if you remember,

Assets – Liabilities = Net Assets, so

Assets = Liabilities + Net Assets

Example of Balance Sheet

Balance Sheet, June 30

ASSETS		<i>Explanation</i>
Cash and savings	50,000	Bank accounts
Accounts receivable	60,000	Invoices you have sent to funders or customers for them to pay you. Note this is not actual money in hand until they pay up!
Fixed assets	20,000	Land, buildings, vehicles, major equipment
Minus depreciation	(2,000)	This is how much the fixed assets lose value every year. That prevents your organization from over-estimating their value.
Total Assets	128,000	This is the total value of everything the organization owns or has in money form.
LIABILITIES & NET ASSETS		
Current Liabilities		
Accrued vacation pay	24,000	This is vacation pay that employees have saved up but not yet taken.
Accounts payable	6,000	These are bills the organization has received but not yet paid.
Total Liabilities	30,000	This totals up how much the organization owes to others.
Net Assets		
Fund balance	50,000	What <i>House of Hope</i> accumulated as of the end of last fiscal year (not counting reserves)
Current earnings	8,000	What <i>House of Hope</i> accumulated as of this fiscal year
Operating Reserves	40,000	What the board of directors set aside
<i>Total Net Assets</i>	<i>98,000</i>	This is the accumulated net worth of the organization, since the day it opened its doors.
Total Liabilities & Net Assets	128,000	Notice this amount is the same as total assets. That is, the two sections balance. That is why this report is called a balance sheet.

Summary of Lesson 2

- ❑ **Budgets** are a tool to help plan how to bring ideas to financial reality for a set period of time.
- ❑ **Income statements** show if we are on track, and how close or far apart our plans are to actual reality, during the *fiscal year*.
- ❑ The **balance sheet** helps show the organization's big financial picture, including assets, liabilities, and net assets, from the nonprofit's birth until now.
- ❑ Taken together, these 3 financial statements help us see the envisioned plans, current situation, and long view of an organization's fiscal health.

Quiz for Lesson 2

- ❑ You've completed this portion of the course, now it's time to see how much you can remember.
- ❑ Click the link below to test yourself and to signal to us that you have completed this section so we can record your credit.
- ❑ No worries – we're not grading the quiz!
- ❑ [Take the quiz](#)