
Introduction to Nonprofit Finance

CompassPoint Nonprofit Services

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Welcome

- 9:30 am – 4:30 pm. 1 hour lunch around noon. A break in the morning and afternoon.
- Come back from break on time
- Sign in & logistics
- Silence mobile phones
- Questions
- Confidentiality

Introductions

- Name, organization, and role
- One thing that you want to learn

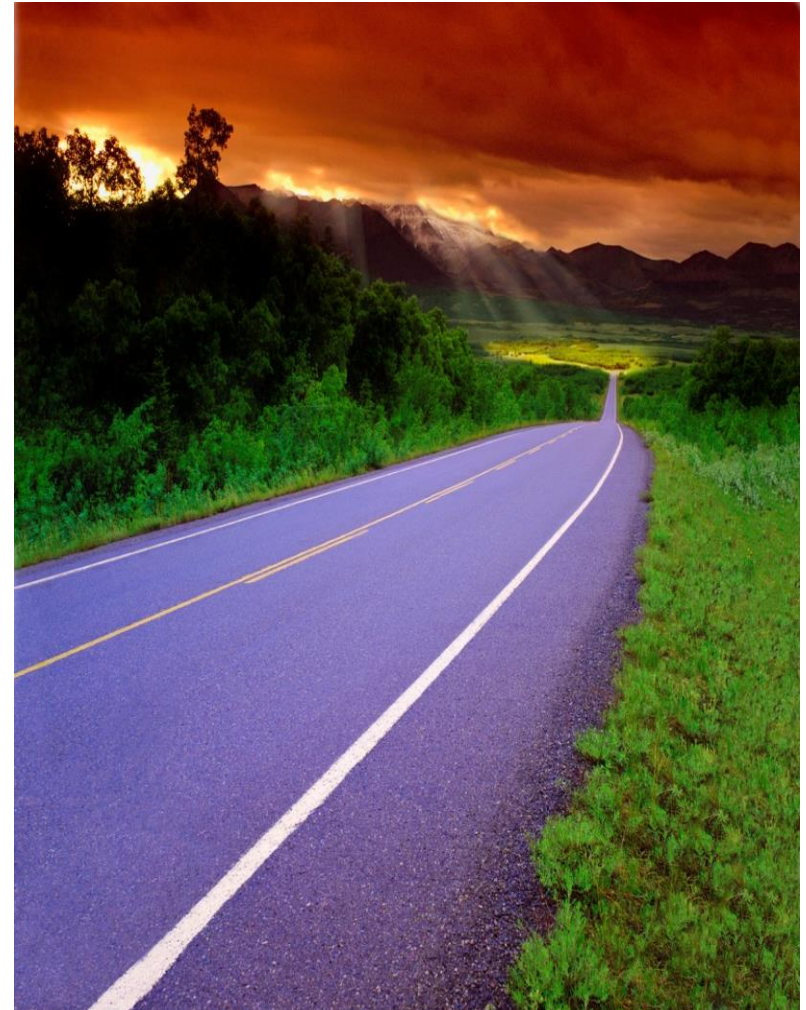
Objectives

By the end of the day, you will be able to:

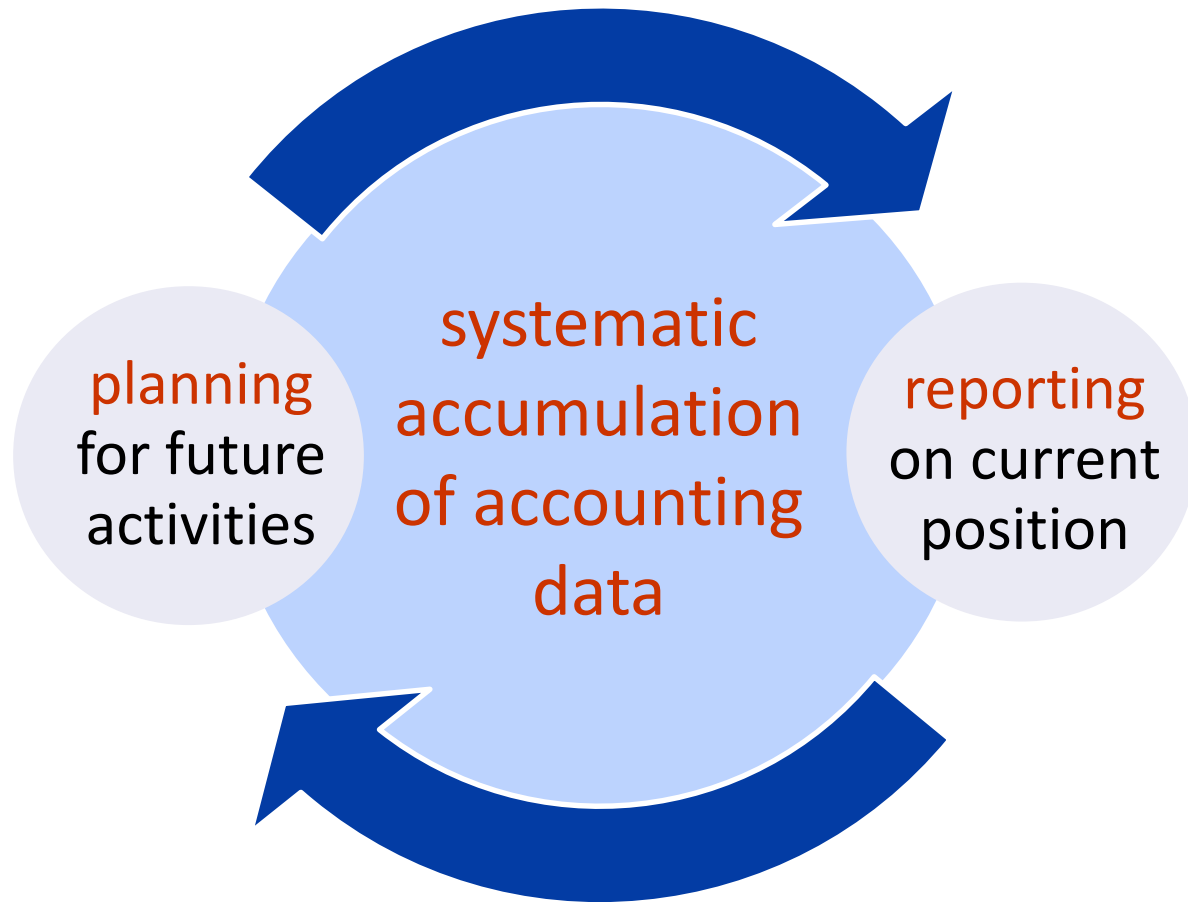
- Assess your organization's financial management system and identify areas for improvement.
- Understand the basic terminology of nonprofit finance.
- Read and interpret key nonprofit financial statements.

Road Map for the Day

- What is Financial Management?
 - Internal Controls
 - Chart of Accounts
- Key Financial Reports
 - Statement of Financial Position
 - Statement of Activities
- Key Accounting Concepts
 - Cash vs. Accrual
 - Recognizing Income
 - Functional Expenses
 - Common Cost Allocation
 - Capitalization & Depreciation



Financial Management: What is it?

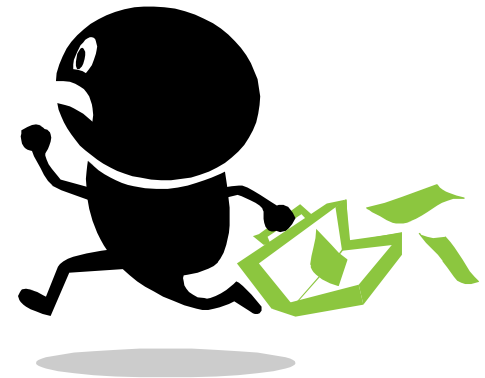


Financial Management: What is it?



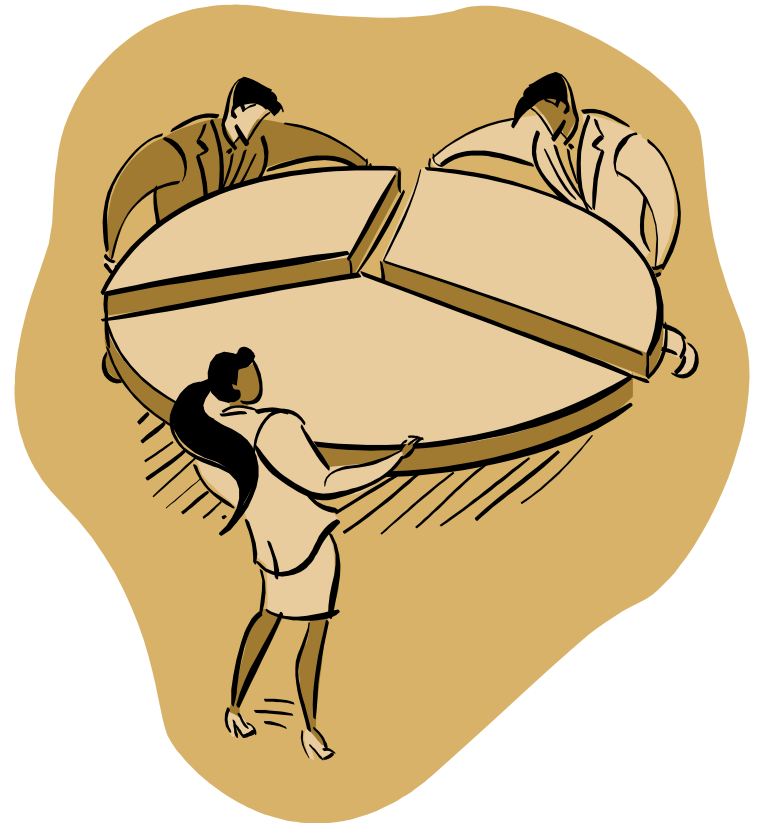
Financial Management: Internal Controls

Internal controls are a set of **policies and procedures** to prevent **deliberate or misguided** use of funds for unauthorized purposes.



Financial Management: Internal Controls

A key principle of internal controls is the **segregation of duties** so that no accounting process is handled by one person from beginning to end.



Financial Management: Policies & Procedures

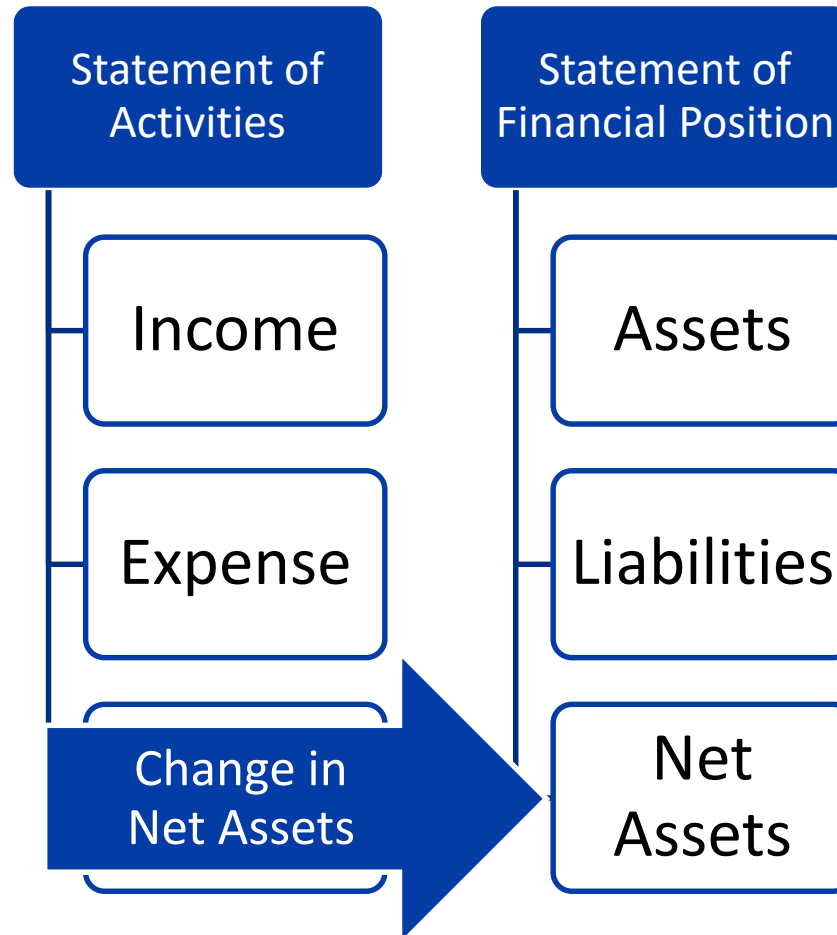
- Policies should be clearly documented and easily understood by individuals outside of the particular department or the organization
- Write policies that you can realistically maintain given the organization's resources;
- Staff members involved in processes should be listed by job title;
- Agency forms relevant to the policy should be cited;
- Relevant time frames should be indicated.

Financial Management: Chart of Accounts

- Includes 3 segments: account, activity, funding source
- Determines how the organization's financial information is organized (internal & external)
- Will be the basis for coding all transactions and designing budgeting templates
- Unified Chart of Accounts can be a starting point for discussion



Key financial statements



Statement of Activities

INCOME -

EXPENSE =

SURPLUS/DEFICIT

Statement of Activities

INCOME -
(Contributed or Earned; Conditional or
Unconditional; Unrestricted or Restricted)



EXPENSE =
(Program, Administration, Fundraising)



SURPLUS/DEFICIT
(Change in Net Assets)

Food.org
Statement of Activities

For the Year Ended December 31, 2012

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Contributions	11,875	-	-	11,875
Foundation grants	15,000	700,000	-	715,000
Total support	26,875	700,000	-	726,875
Government contracts	115,000	-	-	115,000
Interest and dividends	5,750	-	-	5,750
Total revenue	120,750	-	-	120,750
Net assets released from restriction	655,000	(655,000)	-	-
Total income	802,625	45,000	-	847,625
Meal Delivery	443,576	-	-	443,576
Nutrition Education	231,715	-	-	231,715
Administration	57,979	-	-	57,979
Fundraising	68,104	-	-	68,104
Total expenses	801,375	-	-	801,375
Change in net assets	1,250	45,000	-	46,250
Beginning net assets	69,750	5,000	35,000	109,750
Ending net assets	71,000	50,000	35,000	156,000

Statement of Financial Position

ASSETS

What you OWN

Bank Accounts

Accounts Receivable

Property & Equipment

Investments

Minus

LIABILITIES

What you OWE

Accounts/Loans Payable

Accrued Salaries/Vacation

Equals

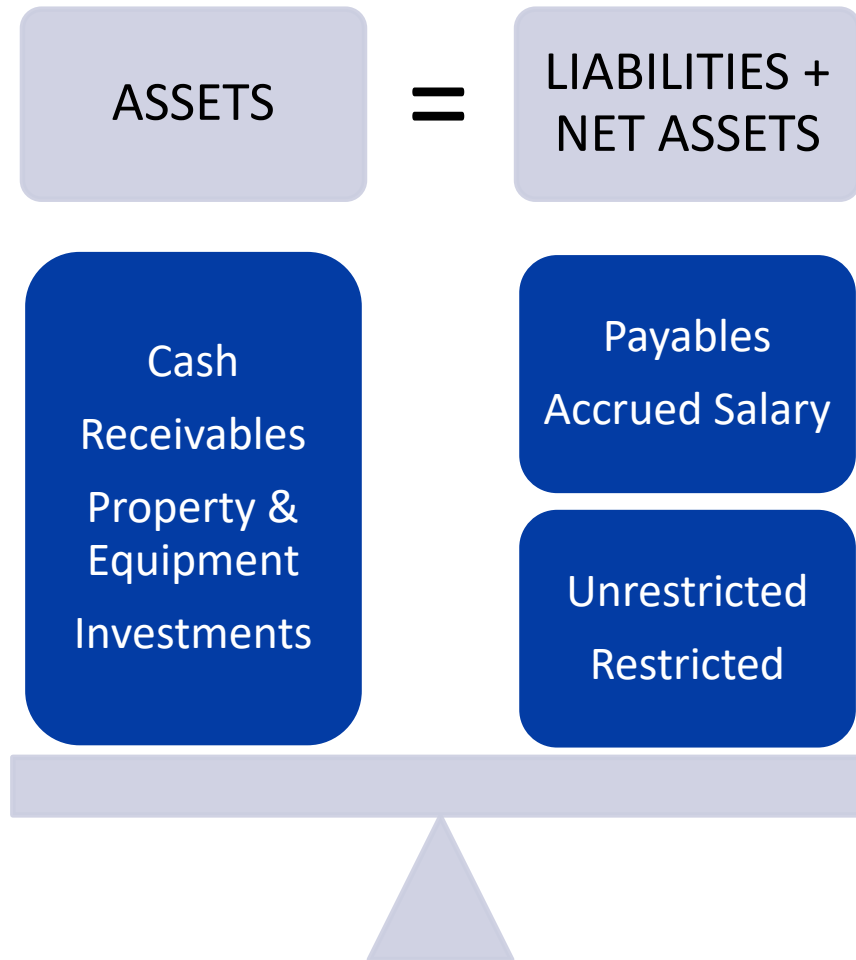
NET ASSETS

What you are WORTH

Unrestricted

Restricted (Temporarily or Permanently)

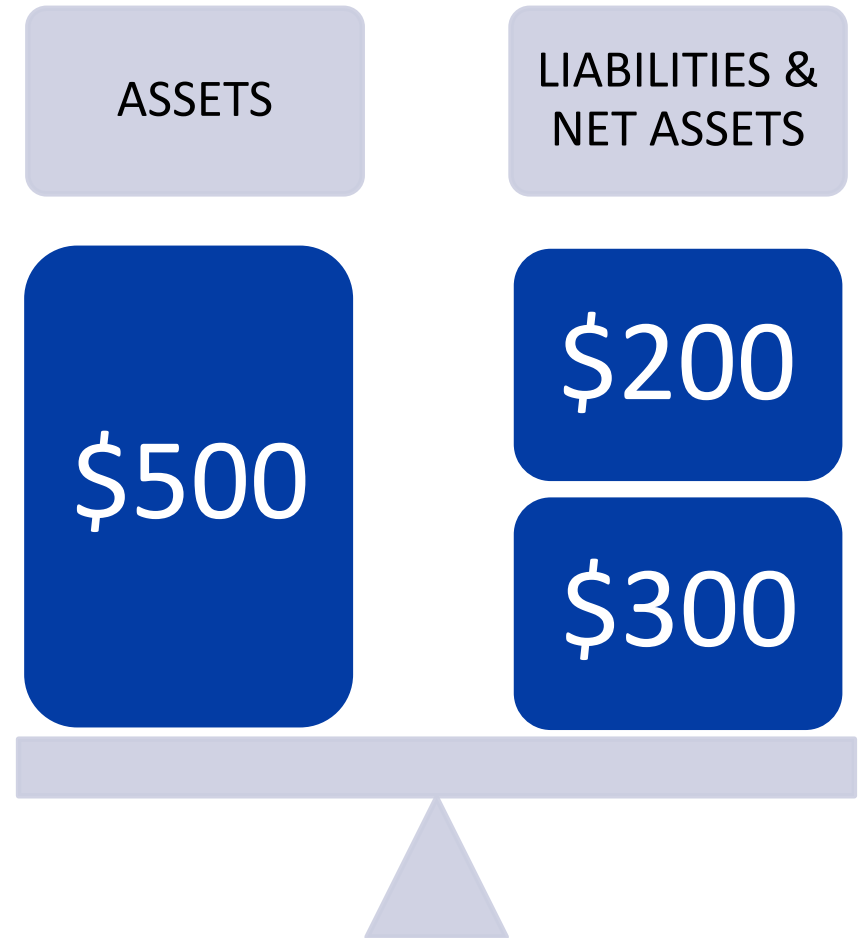
Statement of Financial Position



Statement of Financial Position

We borrowed \$200 from a friend and now have \$500 in our bank account.

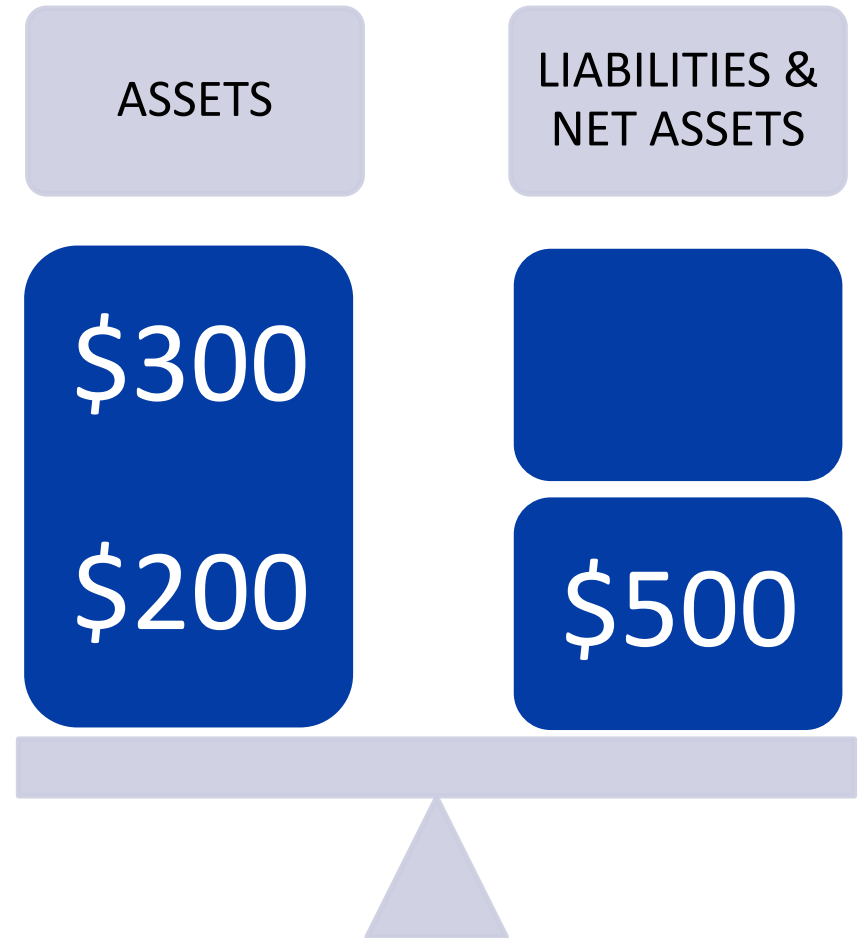
Our financial picture would be as follows:



Statement of Financial Position

We had \$500 in our bank account and then loaned \$200 to a friend.

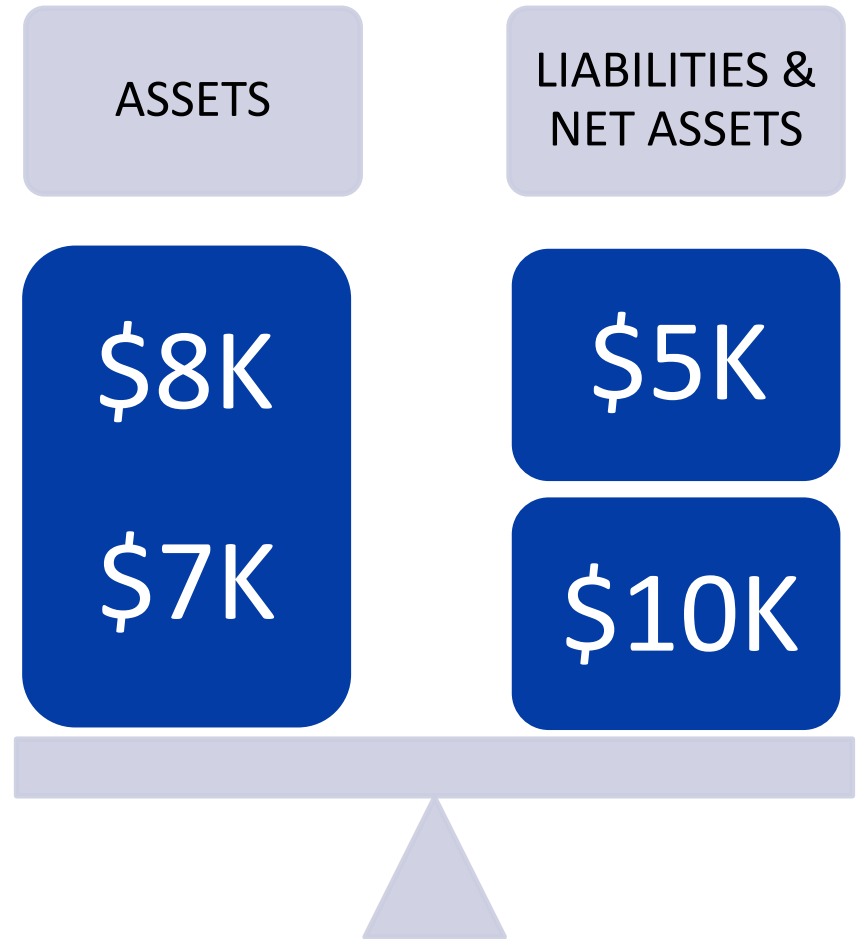
Our financial picture would be as follows:



Statement of Financial Position

We had \$10K in our bank account and bought a car for \$7K. We paid a \$2K down payment and got a \$5K loan.

Our financial picture would be as follows:



Statement of Financial Position
Food.org

As of December 31, 2012

Assets

Cash	73,800
Accounts receivable	25,000
Grants receivable	100,000
Prepaid expenses	1,000
Total current assets	199,800
Capital purchases	44,900
Less accumulated depreciation	(33,700)
Total fixed assets	11,200
Investments	35,000
Total assets	246,000

Liabilities and net assets

Accounts payable	20,000
Accrued vacation	5,000
Line of credit	15,000
Total current liabilities	40,000
Long-term net payable	50,000
Total liabilities	90,000
Unrestricted net assets	71,000
Temporarily restricted net assets	50,000
Permanently restricted net assets	35,000
Total net assets	156,000
Total liabilities and net assets	246,000



Key Concept: Cash vs. Accrual Accounting

- CASH BASIS:
 - Income is recorded when cash is **received**
 - Expenses are recorded when they are **paid**
- ACCRUAL BASIS:
 - Income is recorded when cash is **earned**
 - Expenses are recorded when they are **owed**



- Is your organization on a CASH or ACCRUAL basis?
- How do you know?



Key Concept: Cash vs. Accrual Accounting

JANUARY 2012

	<u>Cash</u>	<u>Accrual</u>
Income:		
1. Invoiced the city for 2,000 units of service at \$5.00 each.	_____	_____
2. Received \$1,000 in new donations during January 2012.	_____	_____
3. Received \$3,000 in pledges during January 2012 that will be paid in March.	_____	_____
4. Received \$25,000 in January 2012 for units of service done during November and December of 2011.	_____	_____
Total income	_____	_____



Key Concept: Cash vs. Accrual Accounting

JANUARY 2012

	<u>Cash</u>	<u>Accrual</u>
Expenses:		
1. Paid December salaries for a total of \$5,000 on January 1, 2012.	_____	_____
2. Incurred \$7,000 in salary and payroll tax expense in January that will be paid on February 1, 2012.	_____	_____
3. Received telephone bill for \$500 on February 10 (all calls were made in Jan).	_____	_____
4. Paid \$2,000 to the auditors in January for services rendered during December.	_____	_____
Total expenses	_____	_____



Key Concept: Cash vs. Accrual Accounting

	ADVANTAGES	DISADVANTAGES
CASH BASIS	Easy to understand Fewer transactions	Not GAAP compliant Incomplete picture
ACCRUAL BASIS	GAAP compliant More meaningful record	Harder to understand More transactions
MODIFIED BASIS	Use easier basis for internal interim reporting	Audit looks different from internal statements; may lead to surprises

GAAP = Generally Accepted Accounting Principles

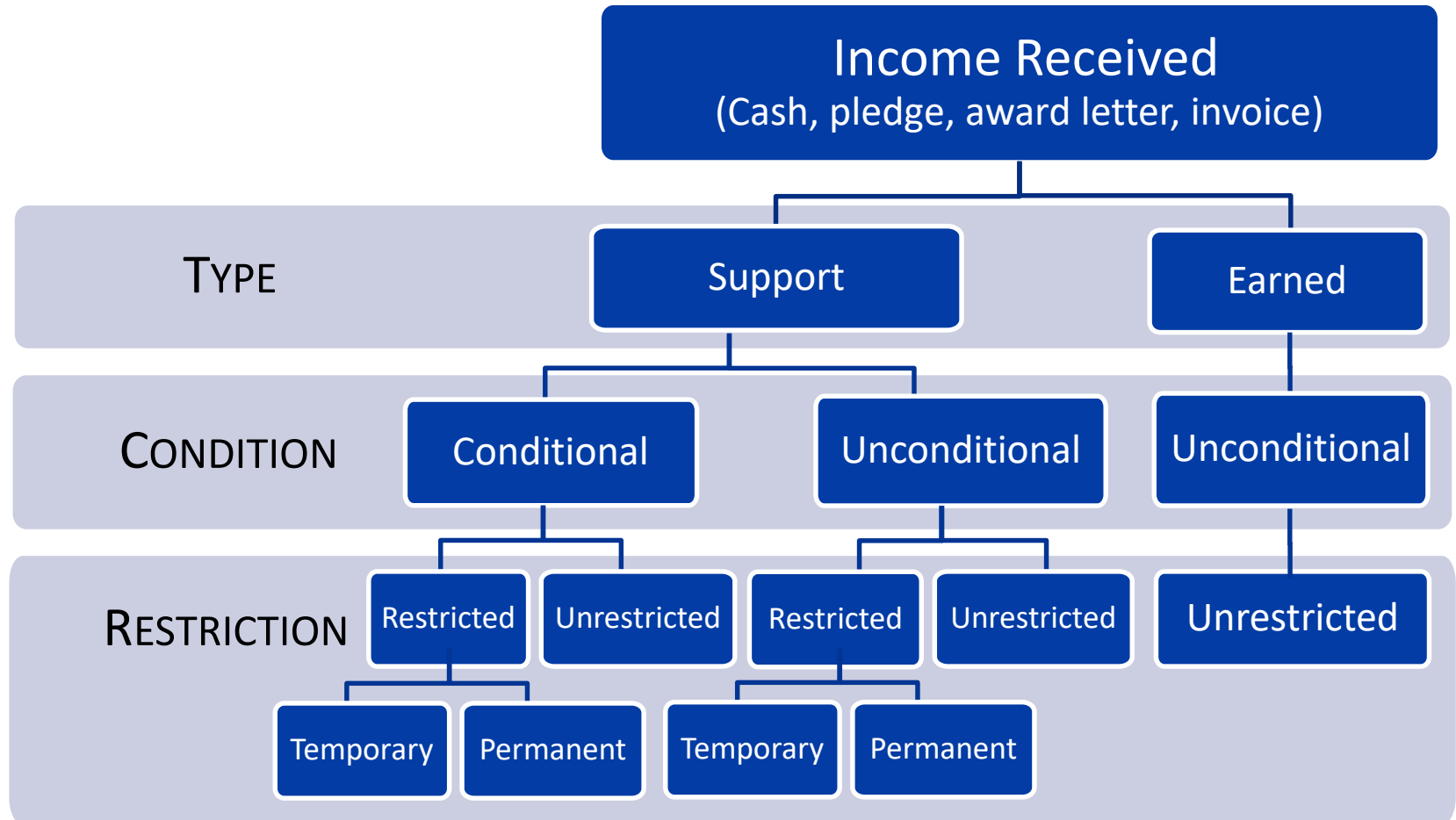


Which is right for your organization?

- Number of transactions
- Expertise of staff
- Size of budget



Key Concept: Accounting for Income





Key Concept: Functional Expense

Program	Costs resulting in distributing goods and services to clients and fulfilling the mission of the organization.
Admin	Costs such as governance, finance and accounting, legal, and executive management.
Fundraising	Costs associated with soliciting contributions.



Think of an expense in your organization - which of these functions does it fulfill?

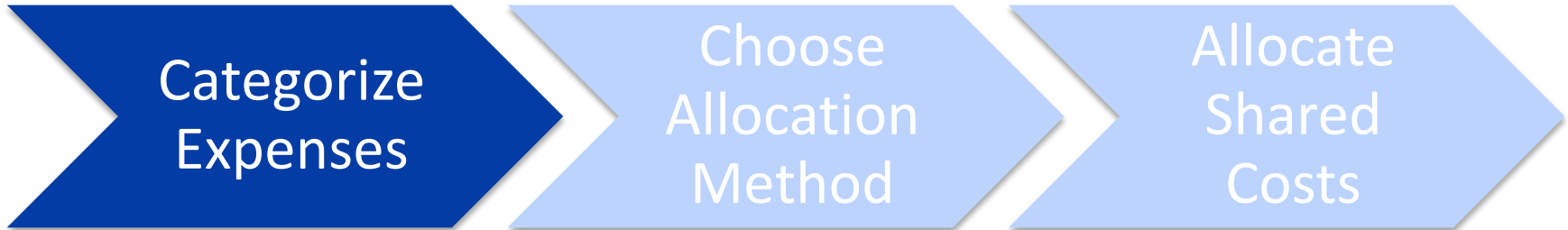


Key Concept: Common Cost Allocation

- **Common costs** (or shared costs) are costs that are not easily identifiable with a single function.
- **Cost allocation** means the process of assigning to two or more activities the costs of an item shared by those activities. The goal is to ensure that each bears its fair share, and only its fair share, of the total cost of the item.
- **Cost allocation plan** means a written account of the methods used to allocate costs.



Key Concept: Common Cost Allocation



Program

Program Director
Client stipends
Program materials

Admin

Finance Director
Audit expense
Board meeting expenses

Fundraising

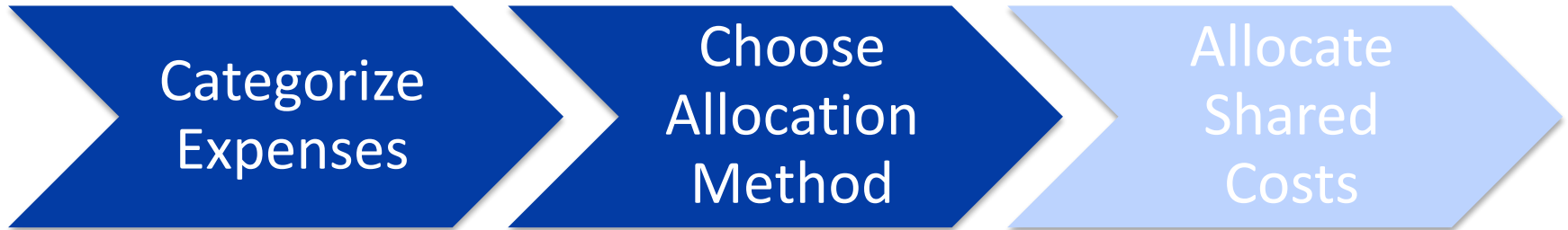
Development Director
Postage for direct mail
Event venue expense

Common Costs

Office supplies, postage, computers
Occupancy (including rent and utilities)
Salaries of staff who support all activities (i.e. Receptionist, IT Manager)



Key Concept: Common Cost Allocation

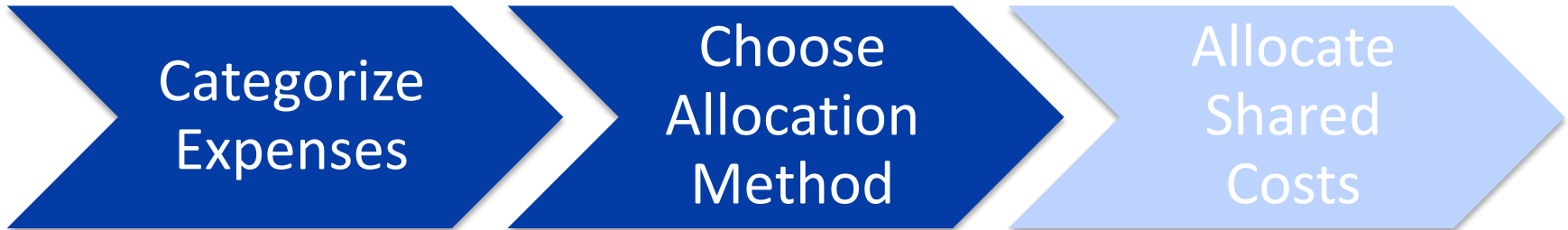


Cost Allocation Method includes:

1. Determine allocation rate(s)
2. Decide how to apply



Key Concept: Common Cost Allocation

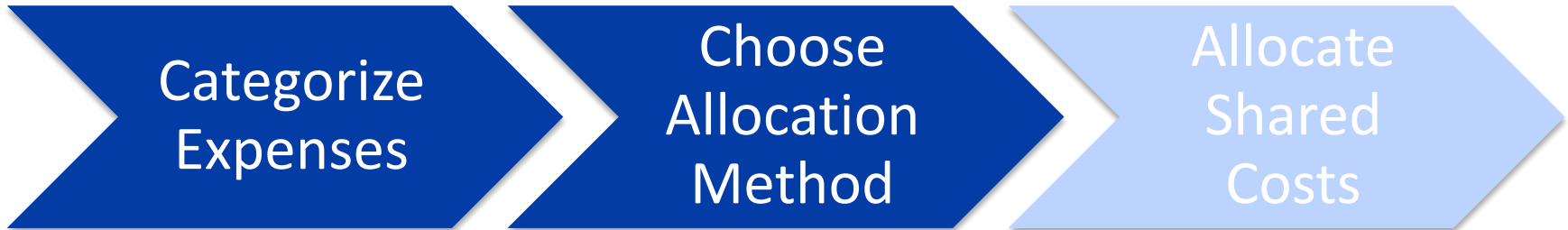


Frequently used cost allocation rates

FTE	$\frac{\text{FTE for Each Activity}}{\text{Total FTE} - \text{Shared Cost FTE}}$
Payroll Expense	$\frac{\text{Payroll Expense for Each Activity}}{\text{Total Payroll} - \text{Shared Cost Payroll}}$
Square Footage	$\frac{\text{Square Footage for Each Activity}}{\text{Total Agency Square Footage}}$
Specific Expense	$\frac{\text{Specific Expenses for Each Activity}}{\text{Total Specific Expenses for the Agency}}$



Key Concept: Common Cost Allocation



The **Line by Line Method** is when an organization determines a different rate of usage for each line item, or groups of line items, and allocates each line individually.



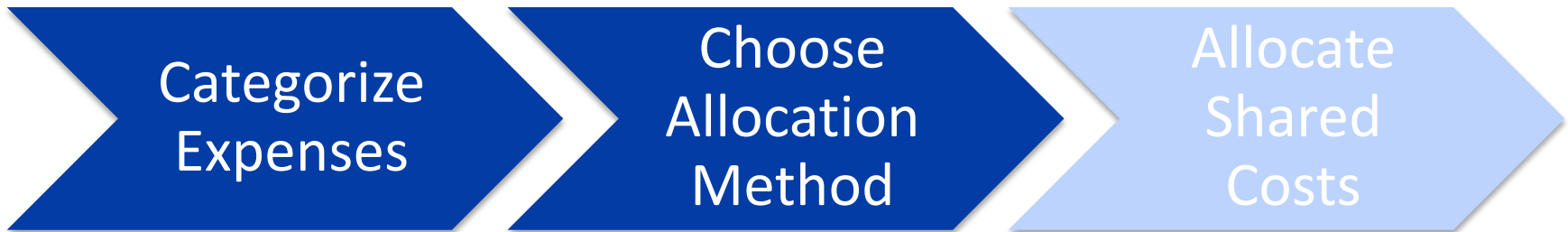
Key Concept: Common Cost Allocation

Line by Line Allocation

	A	B	C	D = B X C	E = A + D
	Meal Delivery Specific	Total Shared	Allocation Basis	Meal Delivery's Portion of Shared	Meal Delivery Direct Plus Shared
Salaries	195,000	45,000	52.78% of FTE's	23,750	218,750
Benefits	48,750	11,250	52.78% of FTE's	5,938	54,688
Personnel expense	243,750	56,250		29,688	273,438
Supplies	25,000	11,000	52.78% of FTE's	5,806	30,806
Telephone	-	21,000	33.33% of telephones	7,000	7,000
Postage	-	18,000	18.50% of meter usage	3,330	3,330
Occupancy	-	78,000	65.00% of square footage	50,700	50,700
Equipment	55,000	2,000	48.00% of copier usage	960	55,960
Printing	10,000	-		-	10,000
Travel	3,750	-		-	3,750
Depreciation	-	10,000	40.00% of computers	4,000	4,000
Training	2,500	-		-	2,500
Non-personnel expense	96,250	140,000		71,796	168,046
Total expenses	340,000	196,250		101,483	441,483



Key Concept: Common Cost Allocation



The **Bottom Line Method** is when an organization groups all shared costs together and uses one allocation rate to allocate the total.



Key Concept: Common Cost Allocation

Bottom Line Allocation

	<i>Program Activities</i>		<i>Supporting Activities</i>		Common	Total
	Meal Delivery	Nutrition Education	Admin	Fund-raising		
Salaries	195,000	115,000	32,500	35,000	45,000	422,500
Benefits	48,750	28,750	8,125	8,750	11,250	105,625
Personnel expense	243,750	143,750	40,625	43,750	56,250	528,125
Supplies	25,000	15,000	-	2,500	11,000	53,500
Telephone	-	-	-	-	21,000	21,000
Postage	-	-	-	-	18,000	18,000
Occupancy	-	-	-	-	78,000	78,000
Equipment	55,000	-	-	-	2,000	57,000
Printing	10,000	10,000	-	2,500	-	22,500
Travel	3,750	1,500	500	1,500	-	7,250
Depreciation	-	-	-	-	10,000	10,000
Training	2,500	1,500	500	1,500	-	6,000
Non-personnel expense	96,250	28,000	1,000	8,000	140,000	273,250
Total specific costs	340,000	171,750	41,625	51,750	196,250	801,375
Allocation rate	52.78%	30.56%	8.33%	8.33%	-100.00%	0.00%
Allocation of common costs	103,576	59,965	16,354	16,354	(196,250)	-
Total expenses	443,576	231,715	57,979	68,104	-	801,375



Key Concept: Common Cost Allocation

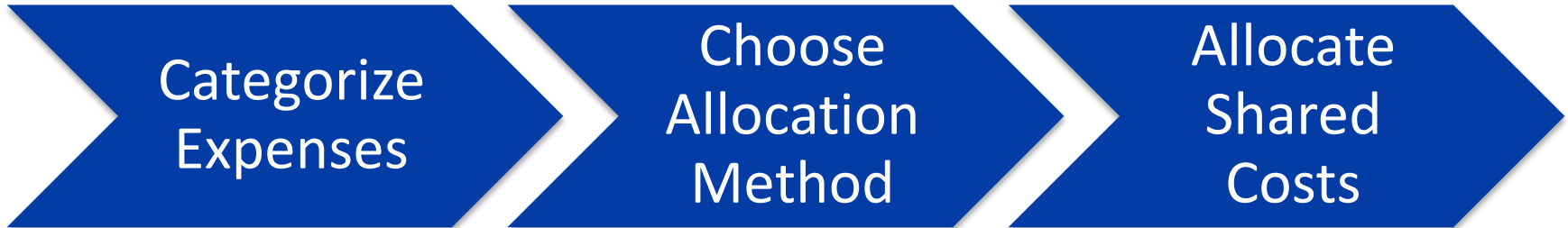
METHOD	ADVANTAGES	DISADVANTAGES
LINE BY LINE	<ul style="list-style-type: none">•Different basis for each line•Can “feel” more accurate	<ul style="list-style-type: none">•Time-consuming record keeping•Feeling of accuracy may be deceptive•May be confusing for program managers
BOTTOM LINE	<ul style="list-style-type: none">•Less time consuming•Allows program managers to focus on line items where they have control/authority	<ul style="list-style-type: none">•Program managers may feel the allocations are inaccurate•When preparing reports to funders, each line will need to be allocated separately



What might be a reasonable and effective cost allocation methodology for your organization?



Key Concept: Common Cost Allocation



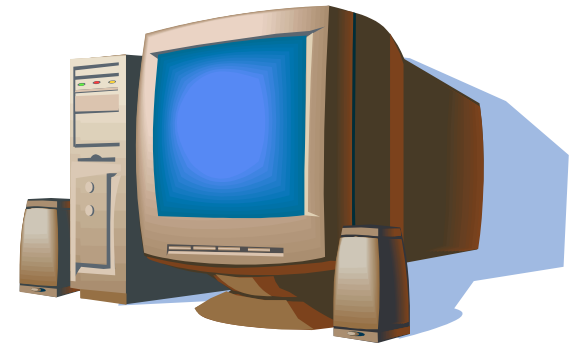
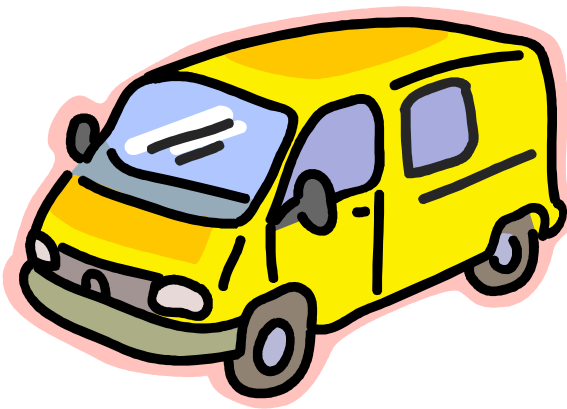
Is the process...

- **Reasonable:** Does the methodology reflect the actual use of resources considering the type of activity and costs?
- **Documented:** Is there a written narrative or clear footnotes on the agency's budget to explain the methodology?
- **Consistently Applied:** Is the allocation methodology applied consistently throughout the organization and over the course of the fiscal year?



Key Concept: Capitalization & Depreciation

Capitalization means an item has a “useful” life of more than a year and is recorded as an asset when purchased rather than expense.





Key Concept: Capitalization & Depreciation

Depreciation is the process by which an organization:

- **records the cost** of a capitalized item over the period that the organization receives benefit from the item
- **reduces the value of the asset** due to wear and tear, age, or obsolescence

Bad Balance Sheets

- What concerns do you have in reviewing these balance sheets?
- What might be going on?
- What questions would you ask to find out more?



Small Group Exercise: Bad Balance Sheet

Statement of Financial Position

As of December 31, 2012

Assets

Cash	(6,450)
Accounts receivable	98,750
Prepaid expenses	4,050
Total current assets	96,350
Capital purchases	12,000
Less accumulated depreciation	(4,000)
Total fixed assets	8,000
Total assets	104,350

Liabilities and net assets

Accounts payable	23,450
Accrued vacation	5,225
Total current liabilities	28,675
Unrestricted net assets	25,675
Board-designated net assets	50,000
Temporarily restricted net assets	-
Total net assets	75,675
Total liabilities and net assets	104,350

Small Group Exercise: Bad Balance Sheet

Statement of Financial Position

As of December 31, 2012

Assets

Cash	108,525
Accounts receivable	15,000
Prepaid expenses	13,000
Total current assets	136,525

Capital purchases	543,000
Less accumulated depreciation	(523,000)
Total fixed assets	20,000

Total assets	156,525
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Liabilities and net assets

Accounts payable	32,000
Accrued vacation	35,000
Total current liabilities	67,000

Unrestricted net assets	(5,475)
Board-designated net assets	50,000
Temporarily restricted net assets	45,000
Total net assets	89,525

Total liabilities and net assets	156,525
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Small Group Exercise: Bad Balance Sheet

Statement of Financial Position

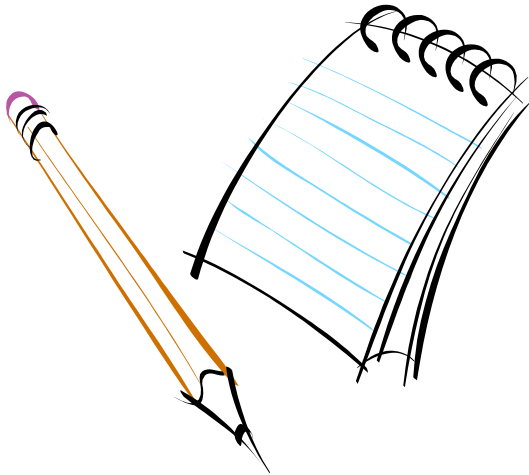
As of December 31, 2012

<u>Assets</u>	
Cash	450,245
Accounts receivable	137,350
Prepaid expenses	25,250
Total current assets	612,845
Capital purchases	48,125
Less accumulated depreciation	(13,770)
Total fixed assets	34,355
Total assets	647,200
<u>Liabilities and net assets</u>	
Accounts payable	1,525
Accrued vacation	5,675
Total current liabilities	7,200
Unrestricted net assets	40,000
Temporarily restricted net assets	600,000
Total net assets	640,000
Total liabilities and net assets	647,200

Action Plan

Three things I will do differently, practice, focus on additional learning, try, or share with my coworkers:

- 1.
- 2.
- 3.



- What is Financial Management?
 - Staffing the Finance Function
 - Internal Controls
 - Chart of Accounts
- Key Accounting Concepts
 - Cash vs. Accrual
 - Recognizing Income
 - Functional Expenses
 - Common Cost Allocation
 - Capitalization & Depreciation
- Key Financial Reports
 - Statement of Financial Position
 - Statement of Activities
 - Form 990

Wrap up & Evaluation

- Other upcoming workshops
- Email me with questions –
shannone@compasspoint.org
- Evaluation
- Thank you!



Objectives

By the end of the day, you will be able to:

- Assess your organization's financial management system and identify areas for improvement.
- Understand the basic terminology of nonprofit finance.
- Read and interpret key nonprofit financial statements.