Tools for Top-Notch CAAs

Section 4: Getting the Most Out of Your Financial Statements

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CAPLAW

A. Introduction

Financial statements are the traditional tool used to analyze an organization's finances as they offer a systematic way to communicate financial information. They serve as the main indicator of financial health and operational stability. While management of a Community Action Agency (CAA) is responsible for preparing the statements, the board of directors is responsible for reviewing and discussing them at each board meeting. To fulfill these responsibilities, all board members must understand the CAA's financial information. Each CAA should commit to developing the board's understanding of its financial health and of the information provided through its financial reports.

Many CAAs find it helpful to ask their independent auditor, another auditor, or the CAA's Chief Financial Officer (CFO) to provide board members with in-house instruction on the organization's financial health and financial information. An approach to increasing board members' financial literacy that can be particularly illuminating is to use the CAA's own financial statements as the basis for in-house training. People are often most receptive to new information when they see how it relates to a problem or task that they must address.

This Toolkit will help CAA boards and management derive the maximum benefit from financial statements by: addressing misperceptions about the importance of financial statements; setting a baseline of understanding as to key accounting principles, terms and concepts; providing both a high-level and in-depth review of the main financial statements boards interact with; describing the different ways to assess financial data; and explaining how boards of directors may prepare and review financial statements and other indicators of financial condition to help an organization more clearly define the role that management and the finance committee will play.

B. Common Myths

✖ Myth 1: "Only a CPA can read financial statements."

Anyone can gain insight into a CAA's finances by reviewing its financial statements. The rules governing how information is presented in a CAA's financial statements are designed to make that information understandable to a lay audience.

Even board members who regularly review financial statements produced by businesses find nonprofit statements somewhat perplexing. CAAs, like other nonprofits, often prepare interim financial statements in non-standard formats or without notes for review at regularly scheduled board meetings. Nonprofit financial statements also divide net assets and income into two distinct categories designed to reflect the degree to which the net assets and income are subject to legal restrictions. Fortunately, education can clarify any confusion triggered by these distinctions.

✖ Myth 2: "Financial statements are only of interest to management, not the board."

Understanding the financial condition of the organization and guiding the use of resources are core legal responsibilities for boards. Financial statements are an important board tool for assessing management's performance and stewardship of the organization and its resources.

CASE SCENARIO #1

Incorporating a Thorough Discussion of Organization Finances Into the Meeting

Blue CAA (BCA) has a board meeting scheduled for next Wednesday night. The packet for the board meeting went out last week, which contained only a statement of financial position. The meeting agenda accompanying the packet includes program reports, a discussion on hiring an assistant vice president of programs, a human resources report on a new employee evaluation form, and routine matters. At the time the agenda was drawn up, BCA's executive director was unsure whether BCA's CFO, Jake Castle, would be able to attend the meeting; however, nobody was all that concerned whether Castle would attend because the discussion of finances usually takes no more than five minutes. Most board members believe that Gloria Watson, BCA's executive director, can report the amount of cash on hand just as well as the CFO, particularly because nobody worries about financial issues so long as there is enough cash to cover 3 months of expenses.

At the board meeting, the program reports on Head Start led to a very lengthy discussion of changes in the menu and the difficulty some children were experiencing eating so many vegetables. In the last five minutes, the chair asked Gloria to report on the finances. She pointed out that the cash balance had slipped slightly below the desired 3 months of operating expense level but noted that she understood that a payment had arrived the day after the financial statements were prepared. A board member asked why the accounts payable and salaries payable line items were so much higher than the previous month but the chair noted that it was time to adjourn and commented that he was confident that BCA always paid its bills on time.

LESSON: BCA's board is being remiss when it comes to financial issues. The board should thoroughly discuss BCA's finances at each board meeting. To facilitate that discussion, the packet sent to board members should include a complete set of financial statements, including the balance sheet, together with a schedule or summary reporting on how expense and income items deviated from budget and basic analysis of the adequacy of the cash position and BCA's progress towards its goals for operating reserves. Preferably, BCA's board would have a finance committee, and that committee would include key financial metrics and a summary of BCA's finances in the board packet. At the meeting, the board should be discussing the results of operations and key asset and liability balances. It should be assessing the adequacy of BCA's financial resources and whether those resources will permit BCA to pay its bills and liabilities in an orderly and timely fashion.

Too often, boards want these discussions to be quick. This is a mistake. No organization can survive on reports about program accomplishments and ideas for new programs alone. At the end of the day, everything comes back to financing programs and new ideas. In fact, as part of their reports to the board, the staff should be asked to discuss the adequacy of program finances and budgetary expectations in addition to offering examples of program accomplishments.

Myth 3: "The external auditors prepare the financial statements and monitor finances."

The professional standards[1] governing auditors are clear: management is responsible for the preparation and the content of a CAA's financial statements. If management is unable to prepare financial statements without significant assistance from the outside auditors, both the board and management are most likely making decisions based on inadequate information. If help is needed to prepare audit-ready financial statements, a temporary solution may be to hire an accounting firm other than the CAA's audit firm. The essential, longer-term solution is either training staff or hiring more highly skilled staff capable of giving the board adequate information throughout the year.

Myth 4: "Because nonprofit CAAs don't make a profit, a board member's knowledge of accounting concepts and principles is not a critical."

CAAs operate like other businesses. They employ people, pay utility bills, rent property, and borrow money from banks. A CAA will face bankruptcy if revenue doesn't exceed expenses or cash flow does not permit the CAA to timely pay its bills. A CAA that ceases to exist has no mission.

The term "nonprofit" can be confusing, leading some board members to believe that a "nonprofit" cannot make a "profit" and must ensure that revenues match expenses exactly. This is a common misunderstanding. The terms "nonprofit" or "nonstock" refer to a corporate legal structure established under state law. Generally, state laws require a nonprofit or nonstock corporation to have a purpose that is not primarily making a profit. Nonprofit CAAs also apply for and receive tax-exempt status from the Internal Revenue Service (IRS). This status means that the CAA is exempt from paying certain federal taxes, such as income and some state sales and property taxes.

While a tax-exempt nonprofit must focus on furthering its charitable purposes, the applicable rules do not prohibit it from generating excess revenue. IRS rules permit tax exempt organizations to generate income greater than expenses resulting in a surplus (basically similar to a profit in for-profit business). IRS rules mainly impose limits on certain types of revenue-generating activities, namely those that do not further tax-exempt purposes. Also, a nonprofit cannot distribute any "surplus" or "profit" to board members or anyone else as a "dividend." Rather, any surplus the nonprofit generates becomes part of its net assets, providing reserves to sustain the organization through hard times, resources to take risks on new programs, and a way to manage cash flow problems that result from government funders delaying payments. Building net assets and adequate cash reserves can be very challenging for CAAs because so many government funding agreements include "use it or lose it" requirements and conditions that limit the use of income earned.

Myth 5: "Mission is greater than any financial concern."

A key saying for nonprofits is "No Money – No Mission." Achieving your mission can easily be constrained by not understanding your finances and failing to provide effective oversight and financial direction.

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[1] American Institute of Certified Public Accountants (AICPA) Ethics Topic 1.200.01 is in Part 1 of AICPA's Code of Professional Conduct and addresses the independence of auditors in the performance of professional services. AICPA is the national professional organization of CPAs and its Code of Conduct is available to AICPA members via its [Online Ethics Library](#).

CASE SCENARIO #2

Finances Affect Mission

Blue Community Action (BCA) is considering a new program to address challenges of young parents struggling with addiction. Some on the board oppose the proposed program approach because it does not require participants to abstain from drug use to enroll in the program. Rather than argue the merits, they may look to the numbers. The opponents may ask an accountant to prepare a financial forecast that assumes a two percent growth in a base grant for the program, and expenses that grow at ten percent per year. Under those assumptions, the program is not financially viable. Those assumptions, however, are open to question. The city and several foundations have expressed great interest in this program and shown a willingness to fund it to the max. Moreover, the forecast does not take into account that adding this program would allow BCA to spread its overhead costs over a larger base, reducing the burden each other program must bear, and freeing some unrestricted funds that are currently used to subsidize programs with inadequate grant funding to cover their share of overhead costs. Unless the program's proponents are willing to challenge a dubious financial assumption, they may yield to the claim that the program will produce a large and unacceptable deficit. But to mount that challenge, the program's proponents must be willing to examine the numbers and underlying assumptions, including the impact on the overall budget, recognizing that the financial facts and figures can be viewed through different prisms.

LESSON: No board member should ever blindly accept financial projections without understanding the assumptions that lie behind them. The executive director and finance director must be open to working with board members to test assumptions and show the results. There are different ways to interpret numbers, and budget proposals are always based on assumptions. Unless a board member understands the assumptions used to create the numbers, they will cede the policy battle to those who are willing to wage the battle based on the numbers.

C. Accounting Principles

Accounting Principles are the body of rules and conventions for financial statement presentation. Board members will hear and see references to these Principles so it is important to know the role they play in an organization's financials and how a board member will interact with these Principles.

What Is GAAP and Who Is FASB?

Generally Accepted Accounting Principles (GAAP) are the main set of rules and conventions that have been developed over time. The Financial Accounting Standards Board (FASB) is primarily responsible for formulating GAAP and now offers a free comprehensive online tool that allows nonprofits to determine the GAAP accounting and reporting requirements for nonprofits in any situation. CAAs may find the American Institute of CPAs (AICPA's) Audit and Accounting Guide for Not-for-Profit Entities even more helpful.

FASB uses an extensive study and review process before deciding to make changes in GAAP. While auditors pay close attention to proposed changes as they wind their way through the FASB decision-making process, for most CFOs the most important issue is to be aware of when changes are adopted and when they must be implemented by nonprofit organizations. Most CFOs make it a point to ask their auditors to let them know when a proposed change from FASB is likely to impact their nonprofit. CFOs may also choose to join the Not-For-Profit Section of the AICPA to gain access to regular updates on GAAP changes and helpful resources for nonprofits. Examples of recent changes that a CAA might discuss with its auditors or accounting consultants include:

- Recording leases for equipment and other items used for operations;
- Identifying and reporting receivables that are unlikely to be collectible; and
- Understanding the Liquidity Disclosure in audits.

The discussion in this Toolkit does not focus on the intricacies of GAAP, but it reflects that body of guidance. No law requires financial statements to be prepared in accordance with GAAP. However, if an organization that does not follow GAAP seeks an independent audit of its financial statements, the auditor's opinion letter must include a modification that the statements do not conform to GAAP. If the CAA has a Single Audit, which is required if the CAA expends at least $1,000,000 in federal funds in its fiscal year, the auditor is required to determine and note in the auditor's report whether the financial statements comply with GAAP.

Given that some funding sources may not accept an audit report with a non-GAAP modification, CAPLAW advises CAAs to adopt GAAP financial policies and present GAAP compliant financial statements.

Requirements for Federal Grantees

Organizations that receive federal awards or subawards must comply with federal funding source rules as well as federal rules concerning financial systems ensuring that the funds are used for their intended purposes.

The key requirements that typically apply to most federal funding are contained in 2 C.F.R. Part 200, the Uniform Administrative Requirements, Cost Principles and Audit Requirements for Federal Awards (Uniform Guidance), which require that the financial management system of each non-federal entity provide, among other items:

1. Accurate, current, and complete disclosure of the financial results of each federal award or program in accordance with the reporting requirements set forth in the Uniform Guidance (specifically § 200.328)
2. Records that identify adequately the source and application of funds for federally-funded activities. Recipient records must contain information pertaining to federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest

3. Effective control over, and accountability for, all funds, property, and other assets, including controls to safeguard all assets and assure that they are used solely for authorized purposes

4. A comparison of expenditures with budget amounts for each federal award

Subpart E of the Uniform Guidance sets forth principles that define the different types of costs (e.g., direct and indirect) that may be charged to a federal award, explain generally how costs may be recovered from a federal award, and identify specific costs which may be recovered from federal awards. The Appendices to the Uniform Guidance guide both nonprofit and public entities in their development of indirect cost rates, which is one way to recover costs that are not readily identifiable with a specific federal award.

The Office of Management and Budget (OMB) in the Executive Office of the federal government is tasked with reviewing and updating the Uniform Guidance and will often issue revisions to the rules when a new administration takes office. An organization should regularly check and make sure that it understands which version of the Uniform Guidance applies to its federal funding.

TIP

Check Your Award Documents

Check your notice of award (if a federal grant or cooperative agreement) or grant agreement terms and conditions (for a state grant or contract) to confirm which federal rules govern your grants. In some cases, states may incorporate other rules relating to program eligibility, allowable costs, and financial systems and statements as well. Check all references to state statutes and administrative rules to be sure you are aware of the requirements you must meet to comply with each agreement.

Federal funding source laws and guidance may establish additional fiscal requirements that an organization must follow. For example, the Community Services Block Grant (CSBG) Organizational Standards speak to how tripartite boards of both nonprofit and public CAAs engage with certain financial information. Standard 8.7 directs a nonprofit CAA's governing board to receive financial reports at each regular meeting that include: (1) an organization-wide report on revenue and expenditures that compares budget to actual, categorized by program; and (2) a balance sheet/statement of financial position. For public CAAs, the advisory body must receive financial reports at each regular meeting as allowed by local governing procedures. Standard 8.9 also requires a nonprofit CAA's governing board to annually approve an organization wide budget while a public CAA's advisory board must have input into the CSBG budget process as allowed by local government procedures.

D. Accounting Terms

The terms in this section are often used to explain an organization's financial health. For board members new to financial statements, and even those with experience, it is important to establish a foundational understanding and language that the organization can use to discuss its financial status and capacity.

Assets. Assets are things of value that your nonprofit owns with a useful life of at least one year. A CAA's assets are listed on the Balance Sheet (Statement of Financial Position) and typically include cash, accounts receivable, prepaid expenses, and fixed assets like land, buildings, and equipment.

Liabilities. Liabilities are amounts a CAA has a legal obligation to pay to another entity. A CAA's liabilities are listed on the Balance Sheet (Statement of Financial Position) and typically include wages and benefits payable, other accounts payable, line of credit payable, and mortgage debt payable. CAAs may also report payments received in advance of providing services as deferred revenue, which is another type of liability. Some CAAs will divide their liabilities into two groups: (i) current which must be paid within one year and (ii) long-term (or non-current) which do not require payment within one year.

Revenue. Revenue is resources a CAA receives either as contributions or through an exchange transaction.

Contributions. Contributions are "non-reciprocal transfers" meaning that the party providing the resources to the CAA does not receive anything of value in return. Most grants and all donor gifts are considered contributions. Even though grants typically require an organization to deliver a service, which is valuable to those assisted and their communities, GAAP does not consider these services to be something of value provided to the grantor.

Exchange transactions. Exchange transactions are those in which the party providing resources received something of value in return. For example, a CAA that provides childcare services for which parents must pay a fee, is receiving resources from the parent through an exchange transaction. Payments from childcare subsidy programs that require the provision of childcare for specific children are also examples of exchange transactions.

Expense. Expense is a cost that a CAA incurs to generate revenue and keep operations running. It represents money flowing out, assets being used up, or new debts being taken on. Expenses are reported on the Statement of Activities. The cost of purchasing assets is not treated as an expense, because the asset will provide benefit for more than one year.

Net Income. In business accounting, the terms net income and net loss refer to the difference between revenues and expenses in a specific period. In nonprofit accounting, the difference between revenues and expenses is described as the change in net assets. When revenues exceed expenses, a CAA reports a surplus. When expenses exceed revenues, a CAA reports a deficit.

Net Income versus Gross Income. Gross income is all earned revenues and/or contributions before any reductions are made for the expenses incurred to generate the earned revenues or contributions. Conversely, net income is the amount remaining after expenses are subtracted from the earned revenues and/or contributions.

Year-end Audited Statements. Year-end audited statements consist of financial statements prepared by management that are examined by an independent auditor. The independent auditor is tasked with determining if management is preparing and presenting financial information using GAAP, which includes presenting information accurately. Year-end audited statements will typically include all final adjustments and footnotes which offer insight into an organization's financial policies, procedures, and approach. Before the audit begins, the board will review financial statements as prepared by management at fiscal year-end. Boards will then review financial statements presented in the auditor's report and consult with the auditors about the differences between management's financial statements and the year-end audited statements.

Interim Financial Statements. Interim financial statements are prepared by management each month and serve as a tool for board members to monitor the CAA's financial health. The finance committee typically reviews statements prepared by management monthly. The full board should review the interim statements at its regular meetings throughout the year. While interim statements should accurately reflect assets, liabilities, net assets, revenues, expenses, and restrictions from funders on the use of revenue and the resulting restrictions in net assets with meaningful comparisons to both prior periods and the annual budget, they often do not include formal notes to the financial statements like those presented in audited financial statements.

TIP

Invest in a Good Accounting System

A board relies on unaudited interim financial statements throughout the year as it makes decisions and cannot rely on an outside auditor to detect mistakes in these statements. The board should value an accounting system that produces accurate interim financial statements. If the statements are incomplete or filled with errors, management and the board may be relying on faulty financial data as they make decisions. For this reason, both management and the board should invest resources in an accounting system that ensures accurate financial data and reports.

Investment in competent fiscal management staff is equally important. CAA accounting is complex, and designing understandable financial reports is extremely challenging. Boards will receive the greatest return on their investment in effective financial management by investing in both highly qualified fiscal managers and regularly updated software that facilitates meeting the CAA's complex tracking and reporting needs.

CASE SCENARIO #3

The Importance of Strong Accounting Systems and Internal Controls

Blue Comunity Action (BCA) and Yellow Community Action (YCA) are two CAAs that are identical in all respects except one. BCA has a stellar accounting system, while YCA's system is deficient in a number of respects. As a result, YCA's monthly financial statements are often incomplete and contain errors. Both BCA and YCA undergo a year-end independent audit. At the end of that process, both BCA and YCA issue financial statements in the same format and in both cases, the independent auditor issues unqualified audit opinions. Before that could happen, the auditors asked YCA to make 54 adjustments to its financial statements. The auditors only asked BCA to make two minor adjustments to its financial statements.

LESSON: An organization's financial accounting system and internal controls make a difference. Throughout the year, BCA's board makes decisions based on accurate financial information. That is not true in the case of YCA's board – it is driving at night with its headlights at half power.

E. Financial Statements

The four basic formats included in GAAP compliant financial statements and that CAAs are required to produce include:

- **Statement of Financial Position (also known as the balance sheet).** The Statement of Financial Position reports a CAA's financial condition as of a given date. It includes assets, liabilities, and net assets—what the CAA owns, what it owes to creditors, and its net worth. This statement functions as a snapshot of the organization's financial health at one point in time.
- **Statement of Activities (frequently called the income statement).** The Statement of Activities, often referred to as the Profit and Loss Statement, reports the cumulative total of revenues and expenses over a specified time period – a month, a quarter, or the organization's fiscal year. The ending date of the period covered by the Statement of Activities must be the same as the date of the Statement of Financial Position presented with the Statement of Activities. For example, a Statement of Activities reporting on the revenues and expenses for the period from January through March will be presented along with the Statement of Financial Position for March 31st. The Statement of Activities is sometimes confused with the CAA's annual budget, but they are two very distinct documents. The Statement of Activities reports what happened in the past, while the budget is a plan or projection of future events.
- **Statement of Cash Flows.** The Statement of Cash Flows reports on the cash received and disbursed over a specific period of time, for example over the period from January 1st through March 31st. The receipt and use of cash is described in three categories: cash from operations, cash from investment activities, and cash from financing activities. The statement demonstrates that the total cash balance reported at the beginning of the period plus the net cash received or disbursed during the period is equal to the total cash balance at the end of the period. The Statement of Cash Flow explains what factors have resulted in a change in

cash balance differing from the net income computed on the accrual basis of accounting. The Statement of Cash Flows often reassures those who are frustrated by accrual accounting that the CAA really does know how it has obtained and used cash and can explain why the net income reported on the Statement of Activities does not equal the increase or decrease in cash over the period being reported.

- **Statement of Functional Expenses.** The Statement of Functional Expenses divides the CAA's expenses incurred during a specific time period (for example January through March) into at least three categories: management, fundraising, and program. These are the same functional categories used on a nonprofit CAA's Form 990 which is the annual informational form that tax-exempt entities must file to maintain their status. Many CAAs choose to expand the category of "program" to present the expenses of their specific programs in multiple columns that are then combined to equal the total program expense.

The **Attachment** to this Guide include samples of each statement along with an in-depth analysis of key features of each.

The year-end audited financial statements, which include the four statements noted above also contain footnotes (in the form of endnotes) that provide background information about the CAA and detail about how various accounting conventions were applied in assembling the statements. These are considered an integral part of the financial statements. When asked to review financial statements, most financial professionals will start with the footnotes. While all CAAs will prepare footnotes to their annual financial statements, many will not prepare complete footnotes to monthly interim financial statements.

One other format that is useful for interim financial reporting but is not a required GAAP compliant statement is a Statement of Functional Revenues and Expenses. The format parallels the CAA's budget and provides management and board members with an opportunity to understand the relationship between revenues available for specific programs and the expenses which are incurred in those programs.

CASE SCENARIO #4

The Footnotes Contain Vital Information

Padma Kumar is a new member of BCA's board. Being a banker, Kumar asked for a copy of BCA's year-end audited financial statements at the time she joined the board. When she looked at the balance sheet, she was puzzled by the $50,000 reserve for unemployment compensation. After reading footnote 8 to the financial statements she has a better understanding of the liability represented by that number. She recognizes that by self-insuring to cover unemployment insurance benefits, BCA may be reducing the annual payments it would otherwise have to make to the state unemployment compensation insurance fund. Kumar, however, is worried that if BCA is forced to lay off employees, its obligation to pay benefits could exceed the reserve. At the board meeting, Kumar asks whether BCA has explored obtaining secondary insurance to protect itself.

LESSON: Kumar did what all experienced bankers and others who regularly work with financial statements do: she read the footnotes to the financial statements to gain a better understanding of the assumptions and conventions underlying the numbers. In this instance, Kumar recognized that BCA might be exposing itself to greater risk than the board realized. She also saw a possible way to reduce that risk while retaining some of the savings from self-insuring BCA's obligation to fund unemployment compensation.

F. Accounting Concepts

The Concepts in this section describe the ways in which an organization will record and report its financial data. Understanding these concepts will give board members confidence in their ability to comprehend what can often seem like overly complex and irrelevant information that is actually extremely valuable to the organization's ability to fulfill its mission.

Accrual Accounting and Cash Basis Methods

Most CAAs use the accrual basis of accounting which is preferred by nonprofit GAAP. For some board members, financial statements prepared using the accrual basis are initially confusing. It is probably easiest to understand accrual accounting by thinking about it in contrast to the other common basis (or method) for accounting, the cash basis (or modified cash basis). Most people are familiar with cash basis accounting because it is how their personal accounts function. Income is recorded when it's received, and an expense is recorded when payment is issued either electronically (e.g., ACH transactions) or by checks to pay a bill. In the cash basis of accounting, income is recorded when a CAA receives payments and deposits them into its bank account. An expense is recorded when checks are written or electronic payments are made. For an organization using the cash basis of accounting, the income statement looks like a monthly bank statement, a reporting of all cash coming in and going out of an account.

The financial reality for a CAA is more complicated. Like most businesses, CAAs have some sources of income that require submitting a billing or request for reimbursement and waiting for the funder to send payment. Similarly, many CAAs pay employees for the work they did in one month on the first day of the following month and have a variety of other bills that are paid in the month after the goods or services are received.

In accrual basis accounting, these realities are described as receivables and payables and are (i) reported on the balance sheet as assets (for the receivables) and liabilities (for the payables) and (ii) included in the income and expenses for the month on the Statement of Activities. The CAA has a legal right to receive what it is owed and a legal obligation to pay what it owes to employees and others. To understand the financial condition of the CAA, the board must be made aware of the whole picture, including the receivables and the liabilities. The accrual basis of accounting presents the impact of receivables and payables clearly whereas the cash basis of accounting does not include recording and reporting these important items. The revenues, expenses, and net income reported on the accrual basis of accounting will thus differ from that reported using the simpler cash basis.

Underlying Principles in Accrual Accounting

Financial accounting and the resulting statements can be confusing to many people because they rely on a series of conventions that attempt to measure something approximating economic income rather than the CAA's net cash intake. The following are just a few examples in which those developing the principles underlying financial statements choose to use the accrual basis of accounting to focus on economic income and wealth rather than cash inflows and outflows.

- **Financial Health.** The accrual basis net income presents a more accurate picture of the true economic outcome of the CAA's activities. Accrual basis accounting is extremely important for understanding the financial health of the CAA. But boards must take care when reviewing accrual basis statements to also pay attention to the CAA's actual cash position. Despite having a legal right to receive the amounts shown as receivable from funders, the CAA will confront serious problems if it does not have sufficient cash available to pay its bills on time.

- **Matching Income to Expenses.** The cash basis of accounting does not make it possible to compare the income that the CAA earned in relation to the expenses it incurred to earn that income. For example, a cost reimbursement agreement may result in having to wait for one or two months to receive payment for expenses that were paid or incurred in the month the reimbursement request is based on. When accrual basis financial statements record the amounts that the CAA is owed or owes others, it impacts both the income statement as well as the balance sheet. This is because recording that the CAA has incurred expenses to fulfill the requirements of a grant for which it is now owed reimbursement from the funder increases the grant income as well as the amount reported as grants receivable.

- **Borrowed Money.** When a CAA borrows money, it has more cash on hand. On first impression, the loan proceeds might be viewed as revenue. However, the CAA also has an obligation to repay the loan. The borrowed funds are thus not treated as additional revenue, and the repayment of the loan is not treated as an expense. Instead, the borrowed funds are recorded as a liability, and repayment of the principal balance of the loan is recorded as reduction in the liability, not as an expense. However, interest on the loan is recorded as an expense.

- **Deferred Revenue.** Deferred revenue occurs when a CAA receives fees for services, and it asks for payment in advance for next year's services. Looking at the cash inflow, many would reasonably conclude that the CAA has income when it receives the cash. However, under the accrual accounting rules, the CAA must recognize the income next year, when it delivers the services, rather than this year. The accounting rules assume that expenses associated with the providing of the services will occur in the next year. By deferring recognition of the income until next year, the CAA better matches the income with the expenses of generating it.

- **Conditional Grants and Gifts.** Accrual accounting requires distinguishing grants and gifts that involve a funder-imposed condition before an organization can report them as either revenue or receivable (if they are waiting for payment from the funder). If the funder provides the funds in advance of an organization meeting the condition, accrual accounting requires reporting the cash they received from the funder and a liability for the advance they are holding. Neither the receivable nor the advance can be recorded as income until the condition is met. Unfortunately, the cash basis accounting for conditional gifts may seriously distort the actual financial position of a CAA. When using cash basis accounting, an organization would record any cash received in advance of fulfilling the conditions as revenue and any amounts not yet paid in cash by the grant are ignored.

- **Depreciation.** A CAA is not permitted to record the entire purchase price of a vehicle or building (i.e., an asset) as an expense in the year that it is acquired because the new car or building will provide benefit over multiple periods. The accrual accounting rules require a CAA to charge or expense a portion of the purchase price in those periods in which the car or building provides a benefit, thereby better matching the expenditure with the periods benefited. The annual expense representing the benefit provided in each period is referred to as depreciation.
- **Vacation Pay Liabilities.** Many CAAs agree to pay employees for unused vacation when they leave employment (and some states require it). A CAA using accrual accounting would record the amount of paid leave each employee earns each month as an expense of that month and would also record a liability, accrued vacation leave. In the accrual method, when an employee leaves the CAA and is paid for the unused vacation leave, the payment would reduce the liability for unpaid leave (accrued vacation leave) and also reduce cash, but it is not recorded as an expense in the period it is paid because the expense has already been recorded in the period in which it was earned.

  If the CAA was using the cash basis of accounting, it would record the amount paid to the departing employees as an expense in the year in which the employee left. There are two problems with this approach. By failing to treat a portion of the future payments the CAA has committed to make to the employee as an expense in the year in which the employee earns the right to receive this payment, the CAA would fail to match the revenue it receives with the expense of generating that revenue. Equally, if not more important, the CAA is not recognizing a future obligation (liability) that could be very large. If the board doesn't adequately keep track of that promise, the CAA may discover that it lacks the resources to meet its obligations when they become due in twenty years.

  The Uniform Guidance permits recipients and subrecipients to use either the cash or accrual basis to compute and record vacation leave payments. As is standard practice, organizations using the accrual basis of accounting are permitted to record the cost of vacation leave in the month in which leave is earned, regardless of when cash is used to pay the employee for use of their accrued paid vacation. Organizations using the cash basis of accounting may not record an expense for paid vacation until the period in which the employee is paid for time covered by their paid vacation benefit.

  This distinction between the rules for CAAs using accrual accounting from those using cash basis accounting can be important for grant funded positions in which the grant ends before the accrued leave is taken. Since cash basis of accounting does not permit charging leave when it is earned, a CAA may not be able to charge the cost of the leave to the grant that an employee actually worked under when the leave was earned. In fact, the grant may be closed when the employee leaves the CAA. Instead, the expense of paying the employee for their vacation leave must be charged to the grant(s) through which the employee is currently being paid. Some funders will deem this an unallowable expense because it doesn't provide benefit to the grant on which the employee is currently working. CAAs using the cash basis of accounting that have a negotiated indirect cost rate are permitted to charge the payment for leave arising from a previous grant to the indirect cost center. But cash basis CAAs without a negotiated indirect cost rate may be unable to charge the cost of the vacation payment to any grant and may be forced to cover it with unrestricted funds.

The accrual accounting conventions applied to a CAA's operations don't create expenses and income, but rather shift income and expenses among accounting periods to better measure annual economic income.

Modified Cash Accounting

Modified cash accounting usually involves making some accrual entries without tracking all receivables and liabilities. Making these entries avoids some of the major distortions of cash basis accounting but does not make it possible to truly match the expenses required to generate income. Under the conventions of the modified cash accounting method, accrued payroll and accrued payroll taxes are recorded as liabilities and as accrued expenses. Mortgage debt is always recorded as a liability and payments on debt are generally segregated into the part of the payment that is for interest, which is an expense, and the portion that is for the payment of principal, which is a reduction in the mortgage liability. While these entries record important liabilities, they do not record all the liabilities the CAA has incurred and owes to its creditors as would be done in accrual accounting. For example, amounts owed to a consultant for professional services would not generally be reported in the modified cash basis, even though they are liabilities that the organization must eventually pay. Modified cash accounting may mislead readers into thinking they are seeing a full picture of the CAA's obligations.

G. Recording and Reporting Gifts and Grants

One of the most confusing aspects of an organization's financial statements is the treatment of funds that are subject to restrictions and/or conditions. While the distinctions can seem overly technical, they are critical as failure to fully understand how to properly treat conditional or restricted funds may lead to unexpected deficits and/or liabilities for an organization.

Restrictions on Gifts and Grants

GAAP accounting rules require nonprofit organizations to determine if grants or gifts received are subject to funder/donor-imposed restrictions. These restrictions consist of the purpose and/or the time period for which the funds may be used. Donor restricted gifts to endowments may require that the body of the gift be retained in perpetuity to generate investment income either for specific purposes or for unrestricted purposes.

The impact of receiving funder/donor-restricted gifts is reflected in both the balance sheet and the income statement. When a restricted gift is received, it is recorded as a donor-restricted contribution with increases to the net assets with donor restrictions. When the restrictions are fulfilled, the CAA records a release from donor-restricted net assets which increases the net assets without donor restrictions and reduces net assets with donor restrictions. Accounting rules permit the nonprofit to present the net assets with donor restrictions in distinct segments, differentiating the purposes and/or the time period for which they are restricted.

Two Categories of Net Assets

Nonprofit GAAP rules require that the balance sheet divides net assets into two primary categories: (1) unrestricted - net assets without donor restrictions and (2) net assets with donor restrictions. The presentation in the financial statements may include sub-segments of each of the two categories, but must clearly present a total of net assets without donor restrictions and net assets with donor restrictions as well as the combined total of all net assets.

Net Assets without Donor Restrictions
These are net assets that are not subject to restrictions imposed by grant makers or donors. The CAA board can use them as it sees fit.

Gifts and grants received without donor restrictions are considered unrestricted. A CAA may decide to present net assets without donor restrictions in segments to increase readers' understanding of its financial condition. Typical segments in net assets without donor restrictions include net assets available for operations, board designated net assets, and net assets Invested in fixed assets. GAAP rules require that all the segments be added together to present total net assets without donor restrictions.

Boards may designate a portion of the net assets without donor restrictions as board designated net assets. The designation requires a formal board resolution that expresses the board's intent to set aside a portion of the net assets without donor restriction for specific purposes or for use in specific time periods. Boards typically use such board designations to establish operating reserves, or reserves for future capital projects. Board designations may also be used to create board designated quasi endowments which are discussed below in the section on Endowments.

Board designated net assets are treated as a portion of the net assets without donor restrictions because they are established by the board which has the power to modify or cancel the designation if the plans and needs of the CAA change. Only donors can restrict funds, so it is important to refer to these board designated net assets as designations.

The board resolution to establish board designated net assets should describe the purpose for which the designated net assets may be used and the process through which the Executive Director may request board authorization to use them. The use of board designated net assets does not get recorded as new income because it represents the use of income already reported in prior periods.

Board designation of net assets may be a very helpful strategy in a board's efforts to build reserves to ensure adequate cash flow or prepare for hard times. If your board is considering designating a portion of the net assets without donor restrictions, you may want to check with your auditor or an accounting consultant to learn about the proper way to account for the creation and use of board designated net assets.

Net Assets with Donor Restrictions
These are assets subject to the restrictions that funders or donors place on the types of activities or the time period for which the funds may be used. By accepting gifts or grants with donor restrictions, a CAA agrees to use the funds only for the purposes specified by the donor, or in some cases, only in the time period specified by the donor.

For many CAAs, the restricted net assets will include funds received from a foundation grant that have not yet been expended for allowable costs specified by the grantor. Until the expenses are incurred to fulfill the restricted purpose, the net assets will be classified as restricted. When the expenses to fulfill the restricted purpose are incurred, the financial statements will reflect the fulfillment of the restrictions as a "release from restricted net assets" which will reduce or eliminate the balance in the donor restricted net assets account.

A CAA may choose to present net assets with donor restrictions in segments to communicate the nature of the restrictions involved. For example, a CAA might present net assets with donor restrictions for homeless services or net assets with donor restrictions for nutrition services. Or the CAA may segregate the donor restricted net assets restricted for purpose from the donor restricted net assets restricted for Time (this category would include net assets associated with gifts that specify that they must be used in future years). GAAP rules require that all segments of the net assets with donor restrictions be added together to present the total net assets with donor restrictions.

Conditional Gifts and Grants

Most CAAs receive a substantial portion of their income from government grants which contain many limitations on how the funds can be used. However, GAAP does not always treat these government awards as "donor restricted." Instead, it is increasingly common to see these awards treated initially as conditional. This means that the CAA is not entitled to consider the amount of the award to be income until it meets the conditions contained within the award agreement. Commonly, these conditions will say that the funds can only be treated as income when allowable expenses are incurred. This is commonly referred to as "use it or lose it" awards.

The issue of conditional treatment of government grants is complicated, making distinctions between (i) grants for which the funder makes the payment in advance or on a regular schedule and (ii) Cost Reimbursement Grants for which the donor requires appropriate expenditure of funds and the submission of a request for reimbursement.

In most cases, the receipt of a conditional grant or gift will not increase either the net assets with donor restrictions or the net assets without donor restrictions. This reflects the reality that the CAA is unable to record the conditional gift/grant as revenue until the conditions are met. One very common use of the concept of conditional gifts is found in governmental cost reimbursement agreements. In these agreements, the grantor/donor notifies the grantee that the grantee may not consider the grant to be income until the grantee satisfies the donor's conditions. Most commonly these conditions involve spending the funds solely on certain allowable expenses. Once the CAA incurs allowable expenses, it may request reimbursement from the grantor. When the grantor determines that the CAA has met the conditions, the CAA may record that portion of the grant as income.

While conditional agreements may initially sound like they are restricted grants, a key difference in a conditional grant is that the grantor does not formally make the gift until the conditions are met and maintains the right to cancel the agreement if conditions are not met. When the grantor provides the funds in advance of the CAA meeting the conditions, the grantor has the right to demand repayment if the conditions are not met. When the grantor does not provide funds in advance of the CAA meeting conditions, the grantor may cancel the agreement or notify the CAA that the CAA is not eligible to receive the grant until the conditions are met.

When a grantor provides cash in advance of the CAA meeting the conditions of a conditional grant, the CAA records an asset - conditional grant funds received in advance. When the grantor determines that the conditions are met, the CAA reduces the balance of this asset account and records grant income. When the grantor of a conditional grant does not provide funds in advance of meeting the conditions, but the CAA receives notification of the conditional award, the CAA does not generally record any entries until the conditions are met. This means that the CAA must start tracking the allowable expenses so it is prepared to request that the grantor determine that the CAA met all or a portion of the conditions and reimburse the CAA for allowable expenses incurred. Once the CAA learns that it has met the conditions and will receive reimbursement, the CAA will record an asset – grant receivable as well as grant revenue.

Due to complicating factors that may arise with conditional grants, CAAs should consider consulting with their auditor or an accounting consultant when working with such grants.

Endowments

Endowments are most commonly a type of donor restricted net asset, but the category may also include board designated quasi endowments which are a component of the net assets without donor restriction. Both donor restricted endowments and board designated quasi endowments are established with a legal charter that complies with the CAA's state law for the management of institutional funds, typically referred as the UPMIFA statute (Uniform Prudent Management of Institutional Funds Act).

Most endowments operate with charters that require an organization to maintain the corpus, the original gifts provided by the donors, for the purpose of generating investment income. An organization may, however, use a portion of the investment earnings for either restricted or unrestricted purposes depending on the terms of the endowment.

The donor restricted portion of the endowment is a component of the net assets with donor restrictions. The board designated quasi endowment is a component of the net assets without donor restrictions. A CAA should seek legal help in setting up endowments and financial help from a skilled accountant to learn how to correctly record the treatment of endowment earnings.

One final note – a common mistake made by nonprofits seeking contributions from donors who have an interest in helping with the long-term financial health of the organization, is to refer to their contributions as "endowment contributions." This can cause both confusion and frustration among donors and may create actual legal problems for the nonprofit if it has not correctly designed and chartered a fund it refers to as an "endowment".

TIP

The technical nature of the GAAP rules for classifying income as unrestricted or donor-restricted or conditional requires that CAAs have highly competent fiscal managers with expertise in nonprofit accounting. Most board members rely on the auditor's opinion for assurance that their organization is correctly recording restricted grants. It is not necessary for board members to become expert nonprofit accountants. Instead, it is important that the board understands the nature of the grants the CAA receives and the presence or absence of donor restrictions or conditions on the net assets. The presence of restrictions on the net assets represents a commitment or obligation to use resources in donor-specified ways. The absence of donor restrictions, represented in unrestricted net assets, identifies resources that the board can direct toward purposes which it believes are in the interest of the CAA.

LESSON: It is important to understand the distinctions among the various types of income to ensure your financial statements are accurate and in compliance with GAAP.

H. Financial Indicators

Budget Variances

CAAs and their boards should routinely review variances between actual revenues and expenses and budgeted revenues and expenses. This review involves comparing key income and expense accounts and resulting net income to budgeted amounts.

Budget variances can provide an early warning, protecting the CAA from unexpected outflows of financial resources and shortfalls in expected revenues. Both management's and the board's responses are far more meaningful if the problems are identified as they occur rather than when the board examines the audited financial statements several months after the end of the fiscal year, when the resulting problems may be insurmountable rather than correctable. In addition to protecting the CAA's fiscal integrity, a careful examination of variances between actual revenues and expenses and budgeted revenues and expenses can provide programmatic and operational insights.

Assume, for example, that labor expense is twenty percent above budget. Management should identify the underlying problem and its plan to resolve it. The CEO might report:

- One program incurred substantial overtime due to increased demand and management plans to add several positions which will result in overall labor savings through reduced overtime.
- Income from the energy program is based on the volume of services provided and is below projections because staff are unable to process the anticipated volume of paperwork. Management plans to retrain staff to streamline processing.
- Management identified an opportunity to reduce labor costs by increasing the number of families assigned to case managers.
- Several employees submitted time sheets with fictitious hours. Those employees were fired and all employees are being retrained on this issue.
- The demand for mortgage counseling services is much higher than anyone anticipated. Several proposals are exploring additional funding.
- The CAA is looking at holding group sessions on early fatherhood rather than relying so heavily on one-on-one counseling.

In sum, budget variances and the entire discussion of finances is an opportunity for a systematic examination of whether programs are operating as planned.

In all CAAs, management should be reviewing the details of variances from budget systematically. The board has some latitude in how it approaches the review of variances. It may want management to provide a detailed schedule, or it might ask management to prepare a short discussion of major variances, the primary causes of the variances, and strategies management intends to use to deal with them. If in reviewing the details of variances from budget, the board opts for a robust and complete schedule, the report should display the variances for the current period (month or quarter) and the year-to-date. It should show both the dollar variance and percentage that the actual revenue or expense line item comprises the budget for that line item.

Some boards might agree to examine all variances above a certain percentage, but a more reasonable and practical approach is to target the examination of variances that are both material and meaningful. Materiality will often turn on the particular income or expense category. As an example, assume the budget shows that the CAA will receive $10,000 of charitable contributions each month. In the past, all contributions came from a fundraising event held in August. Consequently, there is not much point in focusing on a $10,000 variance from the annual budgeted amount in January, but if there is a large cumulative variance in September, the board should determine why the August event failed to produce the expected revenue. The board may also request that staff break the annual budget into monthly segments that reflect the seasonal nature of key revenue and expense items. In this approach, comparison of actual year-to-date income to the year-to-date budget for the fundraising event would clarify that the event was not planned to occur in the earlier months and avoid needless anxiety.

TIP

Demand Specific Solutions to Budget Variances

Management should prepare complete explanations of all material budget variances and management recommendations for addressing them for presentation to the board at its regular meetings. At the next board meeting, management should report to the board on the actions it has taken to address the unfavorable variances discussed at the prior meeting.

Actually addressing a problem is more difficult than simply adjusting numbers on paper. Management should identify the root cause behind each material variance and tell the board the steps it will take to resolve the underlying problem and deal with the consequences of revenue shortfalls and/or cost overruns. Simply adjusting the budget numbers, reducing the budgeted income item, or increasing the budgeted expense item is rarely a solution.

The CAA's management and the board's finance committee should also review budget variances for each program. The organization-wide budget may be meeting expectations, but individual programs may be "busting" their budgets. Problems with one program may be camouflaged when they are aggregated with the other programs. The finance committee should highlight any material program variances during its presentation to the board. The best practice is for management to provide the board with a program-by-program analysis of variances.

If a CAA uses or "borrows" grant funds received for one program, such as Head Start, to pay for expenses (including payroll) for another program, the transaction often violates the first program's terms and conditions. This type of activity may cause serious problems, including cost disallowances and potential program termination. If one grant program's budget is overspent, or funds are not received in a timely fashion, the board should ask management how the costs are paid to ensure that inappropriate funding sources are not being used. Unrestricted funds or working capital loans are the most likely appropriate source of funds, as the CAA must avoid using funds that are restricted to other programs.

One important issue for management and boards to be aware of is the possibility that the accounting system is set up to not permit any program to record expenses in excess of the amounts allowed by the funding sources. In these systems, such costs above the allowed amount are moved to an "unrestricted" or actually "unknown" cost center. Management and the board may assume that because no grant source shows over-expenditure of a grant, there are no problems when in fact there is insufficient unrestricted funding to cover the "over budget" expenses that were moved to an "unrestricted" or "unknown" cost center.

CASE SCENARIO #5

Examining Budget Variances

BCA maintains its books and records on its fiscal year, which runs from July through June. At its October meeting, BCA's board is reviewing a schedule of budget variances for the period ending September 30. This schedule was assembled by BCA's management and was reviewed by BCA's finance committee before the board meeting. Caesar Cruz, the head of BCA's finance committee, is leading the discussion.

Before Cruz can get one word out, board member Maggie Harris asks why personnel expenses are so much higher than budgeted. Actual personnel costs for the first 3 months of the fiscal year (July through September) have consumed 36% of the annual budget amount for personnel even though BCA is only 25% of the way through its fiscal year. Cruz assures Harris that the finance committee asked the same question, particularly because personnel expenses are BCA's largest cost category. Gloria Watson, BCA's executive director, jumps into the conversation. She notes that BCA has been receiving an unusual number of requests for services in one of the programs and has had to pay overtime and even bring in a temporary employee to keep up with the volume of people needing help.

Watson turns the discussion back to Cruz, who then notes that income from government grants and contracts is ahead of the budget, with 29% of the annual budget amount already billed out at the end for the first 3 months.

Cruz says that BCA is billing the state for the unexpected volume of services that Watson just described, and consequently the amount billed is greater than what was planned. The finance committee is concerned that unless the state increases the overall contract amount, BCA will run out of money in this contract for this service before the end of the fiscal year and will have to stop providing it. Loretta Champion, a new board member, objects to any suggestion that people be turned away. Cruz tells her that BCA will have no choice; it just won't have the money needed to keep the program going. He notes that management is already concerned that BCA's cash position is worsening and has actually had to extend the line of credit to borrow more cash to cover its payroll and bills on time.

LESSONS: Watson and Cruz probably weren't looking forward to this discussion. But imagine if there had been no budget, review of variances, or discussion of finances. The board would have first learned of the problems facing BCA a year later, when the audited annual financial statements were distributed. By then, it might be too late to address problems that had a year to fester.

Take particular note of how the variances were reviewed. Management first reviewed them. It then discussed the variances with the board's finance committee. That is as it should be. The examination of budget variances is often viewed as a task for the board. It is, but reviewing variances, identifying causes, and proposing strategies to address them are key management functions. Management should be constantly analyzing the financial data produced by the accounting system. After all, management is charged with running the organization. The board is performing an oversight function, making sure that management is monitoring financial reports, asking the right questions, and operating within the constraints imposed by the organization's financial resources. If there is a problem, management should identify and resolve it.

Management can approach the presentation of budget variances to the board in one of several ways. It can provide the board a complete schedule or a schedule showing just the material variations, or a written summary of the key variances. Less information may be more in this case; presenting just the material variations lessens the chance that the board may get distracted by unimportant issues. In any event, the board should devote meeting time to discussing the variances that are material and problematic.

Liquidity

Liquidity determines the CAA's ability to pay its staff, bills, and other financial obligations on time. The CAA simply must have cash available when it is needed to meet immediate obligations. A CAA's balance sheet may include far more assets than liabilities, but that does not necessarily mean that the CAA can meet its obligations as they become due. For example, the income statement may show grant revenue earned and the balance sheet may have a corresponding line item for grant revenue receivable, but neither of those numbers represents cash that an organization can use to pay employees, the health insurance provider, or the power company. At the end of the day, a CAA must look to its cash position and cash flow which projects cash inflows and outflows over future periods to understand whether the organization has sufficient liquidity. With the assistance of management, the board should take the following steps to assess the CAA's liquidity:

STEP 1: Ask the Fundamental Question

The board should begin by identifying all liabilities that are due within the next 12 months. It should then ask what assets the CAA will use to pay those liabilities.

STEP 2: Consider the Nature of Available Assets

The actions in this step will likely occur alongside the gathering and review of data in the following steps. The board will likely look first at the cash balance and then turn to marketable securities (if the CAA has any investments) and accounts receivable. Marketable securities can be quickly converted to cash, though being forced to sell securities quickly to meet current obligations can result in the CAA taking losses on its investments. This should be avoided by careful cash planning. While accounts receivable usually become cash within a relatively short period of time, if the collection of accounts receivable slows, the CAA must investigate to determine the cause, which may include disputes over the CAA's right to receive the amount it believes it is owed. The CAA must also note any restrictions on the use of cash and other assets imposed by funders.

Use of a comparative format balance sheet can be very helpful here. The comparative format compares the account balances shown at the end of the current month with the balances shown at the end of the prior month. The statement can show the variance between the current month-end account balances and the prior month-end account balances to highlight potential problems collecting receivables or meeting the obligations reported in the liabilities on time.

STEP 3: Review the Statement of Cash Flows

The board should first look at the change in cash balance from the beginning of the period to the end of the period by reviewing the statement of cash flows to gain a better understanding of where cash is coming from and where it is going.

STEP 4: Review a Projection of Cash Flows

The statement of cash flows reports on what has happened to cash in the past. To understand whether cash will be adequate in the future, management should develop and update a cash flow projection. The cash flow projection should identify the amount of cash the CAA will have at the beginning of the next month and then predict the amount of cash it will receive and use each month for the next 12 months, and the cash balance that will result at the end of each month. As each month is completed, management should extend the cash flow projection for an additional month so that the projection always includes 12 months. Management should consider sharing summarized projections with the finance committee and with the full board if significant cash flow problems are identified. A detailed discussion is best left to the finance committee, but when there are significant shortfalls in projected cash flow, the board should have sufficient information to discuss the shortfall. When the projections show an increased number of larger ending cash balances than projected, the board should take the opportunity to discuss how to invest the excess cash (or at least set a guiding policy for approaching surpluses).

STEP 5: Review Aging Schedules

Management should prepare, and the board should receive, an aging schedule for each type of receivable, showing the amounts due within 30, 60, 90, and 120 days, or other appropriate timeframes. The schedule should also identify receivables that the organization is unlikely to collect.

STEP 6: Review Key Metrics

Management should prepare, and the board should review, key liquidity metrics, including the days of cash on hand (distinguishing between restricted and unrestricted cash) and the ratio of net assets available for operations to the annual operating expenses. The finance committee should work with the CEO and CFO to identify the metrics that the board will find most significant. Further discussion of these and other metrics is found in the section “Reviewing Ratios”, which covers key metrics that track the availability of cash when it is needed, building unrestricted reserves, and other indicators of financial health for CAAs.

STEP 7: Review Lines of Credit and Other Loans

The board should periodically review major loan agreements, including lines of credit. Although the types of loans will differ from CAA to CAA, typical ones include mortgages and revolving lines of credit which require “resting” (paying any outstanding balances off fully and not drawing down any additional cash) for specified periods. The board should focus on compliance with loan covenants and restrictions and on the CAA’s ability to retire the loans. Management should work with both internal staff and when necessary, outside counsel, to monitor compliance with loan covenants. The board, or at least the finance committee, should consider reviewing advances and repayments in the line of credit on a monthly basis. This information should be presented along with the receivables report so that board members may compare cash flows, receivables, and use of the line of credit.

CASE SCENARIO #6

Current Assets Went Up, So Why Worry?

BCA's cash balance in the balance sheet dropped by $40,000 during the first quarter of its fiscal year ($160,000 at the end of September, from $200,000 at the end of June). However, BCA’s assets jumped by $270,000 over the same quarter, representing a 13 percent increase. Board member Susan Gallagher has little knowledge or interest in finances. When Lucas Simpson, a member of BCA’s finance committee, and the city’s treasurer, goes beyond the five minutes allotted to his finance report, Gallagher is quick to point out that Simpson’s time is up, and it is now time to proceed with more important matters. She points out that they haven’t hired anyone new and that assets are up by almost $300,000 dollars. “So why do we need to discuss this stuff?”

Simpson points out that BCA’s liabilities jumped from $370,000 to $520,000, or 41 percent. Ava Whipple, another board member, backs Simpson up, pointing to the $100,000 increase in the line of credit. Whipple says, “I am concerned that our line of credit is now over the limit we agreed to, and even with that, our cash balance has dropped. This is really worrying when we’re so unsure about our funding for next year.”

LESSON: Simpson and Whipple are absolutely right to look beyond cash balances and other current assets. The asset side of the balance sheet represents only half of the story. Organizations like BCA are constantly incurring current liabilities and then using proceeds from accounts receivables to pay those liabilities. If the relationship between current assets and current liabilities keeps deteriorating, BCA may be unable to pay employees, the phone company, the utility company, or its other creditors.

BCA has a revolving line of credit with its bank. Typically, lines of credit require that the borrower “rest” the line of credit for one full month each year. This means the organization must pay off the entire balance of the line of credit and not draw on it for the “resting” month. According to BCA’s balance sheet, BCA is only able to rest the line of credit if it can make some real progress collecting its receivables.

The CEO explained that almost the $501,100 in receivables reported at the end of September are from two state contracts. The state has not made payment on BCA’s requests for reimbursement for 2 months. Whatever the reason for the growth in receivables, the board’s task is to understand what is happening and what actions to take. Management should investigate why the state is paying so slowly. It’s possible that the state is reviewing BCA’s requests for reimbursement more closely, with the expectation of denying a significant portion of the requested reimbursement. Alternatively, there may be no problem with BCA's billings, and the source of the delay is within the state's own systems. The CEO should find out what is happening and develop strategies to deal with any further delays.

TWO IMPORTANT TAKEAWAYS: First, boards shouldn't focus exclusively on cash and other asset balances. They must look at the relationship between assets and liabilities, and the status on net assets without donor restrictions that are available for operations. Comparison to balances from the prior period is particularly helpful for spotting disturbing trends.

Second, there is always a story behind the numbers. Sometimes there isn't a problem, but sometimes there is. A board must be willing to ask questions so that it understands the story and can act, if necessary. The board should never assume that management will fix the problem or has everything under control. One of the board's oversight functions is to keep management engaged and focused.

Ratios

Financial statements are often intimidating. More importantly, they do not include analysis, but rather, are just a summary of the financial facts. The statements, for example, may tell management and the board that the CAA had $140,000 in cash on hand as of the balance sheet date, but the statements do not explain whether that amount is sufficient. Management and the board must ascertain what the facts mean and draw conclusions. Financial analysts use a number of metrics, referred to as financial ratios, to help them get a grip on the data. CAA boards and management can do the same.

STEP 1: Identify Key Ratios

There are literally hundreds, if not thousands, of financial ratios that can be created from financial statement information. The board should work with management to identify several meaningful financial ratios that the board can use to monitor the CAA's financial performance and position. This is a case where less may be more, particularly if the board is relatively unsophisticated when it comes to financial matters. In some cases, the board may delegate this review to the finance committee, with the committee instructed to report significant concerns to the full board when appropriate.

1. **Days of Cash Indicator.** Monitoring changes in the days of cash the CAA has on hand is a great way to spot potential cash flow problems before they become troublesome. To estimate the amount of cash needed for one day of operation, divide the annual expense budget by 365 days. To determine the days of cash on hand at the end of the month, divide the month-end cash balance by the estimated cash required for one day of operation.

   Comparing the number of days of cash on hand from month to month provides an easily computed and understood indicator of whether the organization's cash position is improving or deteriorating. It avoids distortions from rapidly increasing or decreasing funding levels. Management and the finance committee can set targets for the CAA's days of cash on hand that reflect the realities of its situation – whether it has access to funds on a draw down basis, whether it often experiences delays in collecting reimbursements from governmental funders, and the extent to which projected revenue levels are relatively certain to be on target.

2. **Liquidity Ratio.** The liquidity ratio is designed to communicate the strength of the CAA's cash position in relation to its obligations. Compute this indicator by adding cash plus marketable securities plus receivables plus inventories and divide the total by liabilities.

   Obviously, a number greater than one is better than a number less than one, but that certainly doesn't guarantee that the CAA is able to convert its assets to cash on a timely basis. If, for example, people who owe the CAA money are unable to pay, having a large value for receivables on the balance sheet is meaningless. As another example, businesses convert their inventories to cash through sales. Nonprofits, however, may be giving away rather than selling their inventories as part of their mission. If that is the case, the numerator should exclude inventories. In fact, the formulation of any metric should take the CAA's particular circumstances and practices into account.

3. **Accounts Payable Indicator.** The accounts payable indicator may provide an early warning sign that the CAA is unable to satisfy its debts as they become due. Compute this indicator by dividing the current accounts payable (excluding long term debts) at the end of the month by the average monthly expenses (computed by dividing the annual budget by 12).

   Both the board and management should ask for explanations if the resulting number is increasing. For example, if the CAA typically has accounts payable equal to 1.5 months of expenses and begins to see that ratio increase to 2 or 2.5 months of expenses, the CEO and board will want to understand why the CAA is delaying paying its obligations.

   Another way to assess whether the CAA is falling behind in paying its bills is for management to prepare an accounts payable aging schedule showing what portion of the total accounts payable are outstanding for 30, 60, and 90 or more days.

   Careful analysis is needed to use either of these approaches since it is possible that the CAA's creditors agreed to these delayed payments. Slowing down the flow of cash leaving the CAA is part of a reasonable strategy to cope with a temporary cash flow problem.

4. **Accounts Receivable Indicator.** If a CAA sees this ratio increase significantly from month to month, it should investigate the cause of the mounting delays in paying accounts receivable. Compute this indicator by dividing the accounts receivable balance at month-end by the revenues reported on that month's income statement. A ratio of 2 will indicate that the average delay in collecting receivables is about 2 months. An increase in this ratio is particularly important if most of the CAA's accounts receivable are actually requests for reimbursement receivable from cost reimbursement awards. Delays in collecting these requests for reimbursement will mean that the CAA must use its own cash to cover the expenses of subsequent months while it waits to collect the receivables.

   The cause of delays may be that funders are asking for more information before making payments or the CAA's system is slow submitting requests for reimbursement. Conversely, the funder may be experiencing staff turnover or having difficulty drawing down resources from federal sources. It is important to learn whether the problem is just a delay or that the request includes unallowable expenses. If the funder makes a final decision not to pay, the

CAA must adjust its books to reflect this reality – reducing the accounts receivable and also reducing the award revenue.

If some of the CAA's programs charge fees and allow participants to pay after the service is delivered, the CAA should separate the accounts receivable which arise from the provision of the fee-based services from those that arise from grants receivable of cost reimbursement requests. The CAA should then divide the month-end balance of client fees receivable by the amount of client fee revenue billed that month. The CAA should set a target for the delay in paying these receivables that it is willing to tolerate and then watch the indicator to see if delays in collecting client fees receivable is increasing.

5. **Expenses to Net Assets.** Comparing total annual expenses (from the annual budget) to net assets is often useful for assessing the CAA's ability to withstand adverse financial circumstances. CAAs with significant fixed assets (land, buildings, and equipment) should exclude the portion of the net assets comprised of investment in fixed assets from the net assets in this ratio. If a substantial portion of a CAA's expenses are related to funding sources that establish restrictions, a CAA may do this calculation in two steps. First divide the total expenses it will incur using restricted sources by the total net assets with donor restrictions. Next divide the total expenses it will cover with unrestricted funds by the total Net Assets without donor restrictions (minus the fixed assets as described above). Finally, combine all expenses and divide them by the total net assets minus the net assets invested in fixed assets.

6. **Net Income Indicator.** One way to measure the extent of surplus is the savings indicator which shows the percentage of total expenses that the net income comprises by dividing the net income (revenues minus expenses) by total expenses.

   Most CAAs have limited opportunities to grow net income because most governmental funding agreements are structured in "use it or lose it" terms. The CAA is thus generally not entitled to receive or keep any revenue that exceeds the amount of allowable expenses permitted by the agreement. This reality makes it difficult for CAAs to build their net assets. CAAs that are committed to improving their sustainability must figure out strategies to obtain funding that allows them to have revenues exceed expenses.

   With this indicator, CAAs must consider whether the source of the "surplus" is restricted gifts and grants that are available only to meet the restricted purposes or timeframes required by the donor/grantor. For this reason, CAAs should distinguish unrestricted grants/gifts from donor restricted gifts/grants and insist that its accounting system provide a clear presentation of the distinction between surpluses that represent "carry over" (i.e., restricted funds that must be spent for specific purposes) from unrestricted surpluses (i.e., funds that are available to build reserves or invest in new initiatives).

7. **Total Debt to Total Assets.** Organizations have long compared their debt to some base. One way to do this is to compare total debt to total assets. Not surprisingly, there is not one right percentage for the total debt to total assets ratio. In fact, there is a great deal of variation in this number among different industries. Utilities, for example, incur a lot of debt relative

to their assets because they have very predictable streams of revenue. On the other hand, tech companies are notorious for incurring little debt relative to their assets. The reason is quite simple: tech companies have very unpredictable revenue streams, and even when a tech company has a runaway bestselling product, that product may soon be obsolete. Similar variations should be expected among different parts of the nonprofit sector. Certainly, CAAs finance their operations differently than hospitals, universities, or museums do.

Another problem with this metric is that a CAA could hit the target but find itself in financial trouble if the terms of a loan requiring an immediate payment, but insufficient cash is on hand to make the payment.

Once again, all financial ratios are useful only if they are first customized to fit the organization's particular facts and circumstances, and then used to identify trends and spark questions.

STEP 2. Make Proper Comparisons

A board must not use ratio analysis as a mechanical benchmark; rather, ratio analysis is best undertaken on a comparative basis.

- **Internal Trends.** A CAA's management and board should monitor any given ratio over time. If, for example, a CAA's days of cash on hand indicator hovered at 45 days for the last five years, management and the board should ask lots of questions if the indicator suddenly drops to 20 days. In other words, the focus should be on why a number has changed, not on hitting a particular number. While it is often helpful to set a target for indicators like days of cash on hand, the targets should be re-evaluated periodically to ensure they are still relevant. For example, if a CAA that was previously funded almost entirely through federal awards which permitted drawing down cash from the Federal Treasury then shifted its funding mix to include major agreements that provide cash on a cost reimbursement basis, the CAA will need to increase its target for days of cash on hand to reflect the need to meet cash demands while waiting for reimbursements.

- **Other Organizations.** Many organizations simply are unable to obtain the necessary information to produce a meaningful list of comparative entities. Even if some of the information is available through Form 990s or other publicly available sources, the analysis is likely only meaningful if the mix and source of funding is similar for all organizations included in the comparison.

STEP 3. Monitor Trends

A relatively simple way to monitor trends is to use the comparative format for the CAA's balance sheet. By comparing this month's ending balances in balance sheet accounts to those of the prior month-end or prior quarter-end, a CAA can quickly see which direction things are moving. Is cash going up, are receivables going up, are payables increasing or decreasing? To make this strategy work well, the CAA must focus on the most significant line items on the balance sheet and pay attention to patterns through graphs that will make the trends even clearer.

A version of this same concept is possible on the statement of activities by producing a version of the CAA's revenue and expense report with columns for each month's actual revenues and expenses, as well as showing the totals year to date. This report allows the CAA to spot significant increases or decreases in revenue and expense accounts easily. However, caution is needed to avoid wasting time investigating minor variations or obvious seasonal impacts. Management can help the board by using the data to project year-end balances in major revenue and expenses accounts and the resulting projected net income. Projecting the year end balances focuses attention on important questions about achieving revenue and expense targets.

STEP 4. Allocate the Work

Management should use ratio analysis to keep the CAA on solid financial footing. For that reason, the board, including the finance committee, should look to management to prepare the ratios and the analysis. That, however, does not mean the board is passive, accepting what management gives it. The finance committee should discuss the ratios or other indicators that would be helpful to its understanding of the CAA's financial health and progress toward financial goals with management. Both the board and management should understand that the goal is not to create a larger list of indicators, but rather to select those that provide the most meaningful information to support effective board oversight.

I. The Review Process

Every regular board meeting should include a review of the CAA's financial statements, whether year-end audited statements or interim statements. Typically, the interim statements are less formal than the audited ones, but if the CAA's accounting system is a good one, these statements should be relatively accurate. To give board members the information they need for effective oversight and direction setting, the interim financial statements must include a statement of financial position (balance sheet) and an organization-wide statement of activities (income statement) with comparisons to budget. The interim statements should include program-by-program revenue and expense reports and compare actual results achieved to specific program budgets. Most CAAs will expect their management to perform the most detailed comparisons of program-by-program and grant-by-grant revenues and expenses to budget and bring unexpected results to the attention of the finance committee and/or full board. One approach to a review process is as follows:

STEP 1: Review by the CFO and Executive Director

The Executive Director's review of the financial statements provides an essential control to ensure that the statements are complete and accurate, and that all financial information that the Executive Director is aware of is communicated to the CFO or Fiscal Director and is reflected clearly in the reports. The CFO or Fiscal Director's review should focus on identifying any underlying financial problems that should be pointed out to the Executive Director and the finance committee.

Many Executive Directors and CFOs also expect Program Managers to review financial reports of income and expenses in comparison to budgets for programs. This review provides an important additional opportunity to spot errors or omissions in the preparation of the statements.

STEP 2: Preliminary Review by the Finance Committee

The CAA board should have a standing finance committee. The finance committee should review the financial statements in advance of the board meeting, prepare an analysis of the statements to send to all board members before the meeting, and designate the committee chair or another committee member to report on the statements at the board meeting. If the CAA board does not have a finance committee, the board should designate the Treasurer to review the statements in advance of the meeting and lead the discussion. The Treasurer should work closely with the CFO or Fiscal Director to ensure they have a clear understanding of the statements and of any issues that should be pointed out to the board. The CFO or Fiscal Director should be present at the board meeting and prepared to answer questions that board members raise.

STEP 3: Review by Every Board Member

Ideally, every board member should receive a packet of financial information at least one week in advance of the scheduled board meeting. The packet should include a complete set of financial statements, and if possible, an analysis of the statements from the board's finance committee or the CAA's CFO or Treasurer. Each board member—no matter how financially literate—should review the financial statements before the meeting.

STEP 4: Regular Discussion of the Financial Statements

The meeting agenda should set aside sufficient time to permit a thorough discussion of the financial statements. The discussion should include a review of:

- **The Statement of Financial Position (or the Balance Sheet), specifically:**
    - Liquidity—the CAA's cash position in relation to its obligations;
    - Net assets without donor restrictions available for operations; and
    - Net assets with donor restrictions.
- **The Organization-Wide Statement of Activities (or Statement of Revenues and Expenses), specifically:**
    - Organization wide variances from budget—comparison of what happened with the annual plan;
    - Organization-wide net income compared to the budget plan; and
    - Donor restricted grants and contributions separated into revenue that is unrestricted and restricted with only the portion for which restrictions are met included in the revenue for the current period and in the net income calculation.
- **The Statement of Cash Flows, specifically:**
    - Increase or decrease in cash over the period reported on the financial statements;
    - Division of increasing or decreasing cash into three activities: operating, investing, and financing; and
    - A cash flow projection if accounting software struggles to accurately generate a Statement of Cash Flows.

- **The Statement of Functional Revenues and Expenses, specifically:**
    - Program-by-program analysis of revenue and expenses;
    - Revenues and expenses associated with each program, management, and fundraising;
    - Generation of sufficient income to cover costs in program, management, and fundraising; and
    - Generation of sufficient income by each program to cover its fair share of management and overhead costs.
- **Overall financial health, including:**
    - Key financial metrics – stability of grants and other revenue sources;
    - Progress toward goals for net assets without donor restrictions;
    - Progress toward achieving target days of cash on hand; and
    - Any other matters involving finances warranting discussion.

STEP 5: Once-a-Year Discussions

At least once a year, the board should engage in the following (though not necessarily at the same meeting):

- Review auditor's annual report and management letter;
- Meet with the auditors absent the Executive Director/staff to learn about any concerns the auditors have about fiscal staff expertise and the adequacy of system and reports;
- Approve annual organization-wide budget;
- Review system of internal controls;
- Assess overall financial health, including liquidity and unrestricted net assets; and
- Consider long-term financial plans and needs.

STEP 6: Questions and Answers

Time should be set aside during each discussion of the CAA's finances for a robust Q & A session. Questions should be encouraged.

CASE SCENARIO #7

A Complete Set of Statements

BCA's CFO, Jake Castle, decided that providing the board with a complete set of financial statements is a mistake. In Castle's view, the board should review a detailed schedule showing each program, the revenue associated with the program, and the related expenses. He does not provide a balance sheet presenting assets, liabilities, and net assets, and also does not provide a comprehensive organization-wide statement of activities that presents income and expenses from all activities and the resulting changes in net assets. Castle believes CAAs are unique because of their reliance on multiple government revenue streams that must be used for specified purposes. In his view, organization-wide financial statements make no sense because grant revenue from one program (e.g., weatherization) cannot be used to finance another program (e.g., Head Start).

BCA has a revolving line of credit to ensure it has cash available to meet its obligations on time. The bank that provides the line of credit evaluates BCA's ability to repay the line of credit based on the financial condition of the organization as a whole. Similarly, BCA's trade creditors (e.g., the electric utility, suppliers, communications company) focus on BCA as an entity rather than on particular streams of revenue.

LESSON: Castle is providing the board with useful information, but he is ignoring the value of organization-wide financial statements. A board member who does not receive a complete set of financial statements, including the balance sheet, should request them. Those who think board members won't understand them or will be confused are doing everyone a disservice, including themselves.

Castle should keep one fact squarely in mind: providing the board with a complete set of financial statements does not preclude him from supplementing the financial statements with schedules that show operations on a program-by-program basis. One effective option is to use a columnar approach to the income statement, including both the totals for each category across the organization, and a breakdown across the columns by grant or program.

To understand the bank's concerns as to BCA's ability to pay its obligation, the board needs to look at the entity as a whole to make sure that there is sufficient liquidity to satisfy BCA's bank. The board should look at BCA through the eyes of those creditors. Moreover, not all assets are restricted to a particular program. Most organizations have unrestricted cash, receivables, and fixed assets (equipment and buildings). The board should monitor these on an ongoing basis. Finally, if the board wants to expand into new areas, it needs to understand the funding resources and cash available for expansion.

J. Concluding Thoughts

A CAA's financial statements contain important information. Many board members who are unfamiliar or uncomfortable with financial matters may decide to ignore the statements. This is a mistake. Here are some basic principles to keep in mind.

- Board members have a legal duty to monitor finances, which means reading the financial statements.
- Anyone can read financial statements. It just may initially take some effort, but it's worth it.
- If your financial statements are unclear or confusing, even to board members with some experience with financial information, the board may need to discuss making improvements in the financial statement formats or requesting additional training to understand the CAA's financial position.
- Finance and mission are integrally linked. The financial statements provide an opportunity to discuss the CAA's mission in an organized and meaningful way.
- The financial statements measure financial performance and condition. They do not, however, measure whether a CAA is achieving its mission. The board should spend considerable time discussing whether the CAA's programs are effective and how to best measure effectiveness.

Attachment

Introduction to Sample Financial Statements

This section includes six sample financial statements in formats that are useful to Community Action Agencies:

1. Statement of Financial Position (Balance Sheet)
2. Statement of Activities in Columnar Format
3. Statement of Activities in Stacked Format
4. Statement of Cash Flows
5. Statement of Functional Expenses
6. Statement of Functional Revenues and Expenses

Here are some key elements to look for in each of the sample statements:

1. Statement of Financial Position (Balance Sheet)

This statement reports on Assets, Liabilities, and Net Assets at a specific point in time – typically the last day of the month, quarter, or year. The sample presents the information on a comparative basis, meaning that it compares the balances from the date of the statement to the balance from an earlier date, typically the end of the prior month, quarter or year.

A board member may ask about the following:

- Under Assets, why is the cash so low and the receivables so high? Is the CAA struggling to receive payments?
- Under Liabilities and Net Assets, specifically, Net Assets without Donor Restrictions, why is the Invested in fixed assets amount lower by $10,000 and the Available for operations higher by $20,000? Did the CAA sell an asset?
- Under Liabilities and Net Assets, specifically, why did Net Assets with Donor Restrictions increase by $150,000?

2. Statement of Activities in Columnar Format

This is the format commonly used in audited financial statements. It uses two separate columns to report on revenues without donor restrictions and revenues with donor restrictions and shows the release from donor restrictions as an increase to unrestricted income and a decrease in donor restricted income.

A board member may note the following:

- The release from donor restrictions is indicated with the use of parentheticals, e.g., ($700,000)
- The release reports on the use of donor restricted funds for the purposes or time period for which the donor has restricted them. A board member may ask about why the release occurred.
- This format displays the GAAP convention that treats all expenses as unrestricted. This convention is alluded to in Two Categories of Assets, Net Assets with Donor Restrictions under G. Recording and Reporting Gifts and Grants. When incurring an expense fulfills a donor

restriction, the expense is considered unrestricted while the amount of restricted net assets consumed by the expense is treated as a release from Donor Restricted Net Assets in the revenue section. By showing the release as a positive number in the Unrestricted column (as well as a negative number in the Donor Restricted column), the CAA is showing that the release amount is supporting an unrestricted expense. This GAAP concept is often hard to grasp but is important as it indicates the moment when expenses relating to fulfilling donor restrictions are transformed from being restricted to unrestricted.

3. Statement of Activities in Stacked Format

This report also focuses on the distinction between revenues without donor restrictions and revenues with donor restrictions but displays the information in a different format, placing the unrestricted activity in the top portion of the statement and the donor restricted activity in the bottom portion of the statement. While the sample reports on the CAA as a whole, i.e., showing all the revenues and expenses recorded in all cost centers for all functions under one column, this same format may be used to report on each specific program and/or on each specific grant or contract in separate columns.

A board member may note the following:

- This format provides room to present a comparison of the actual revenues and expenses that have occurred in the reporting period to the budget, either for that period or for the full fiscal year
- This format uses percentages to demonstrate the relationship between the actual revenues and expenses for the period and the budget plan.
- High percentages, such as the 283% of the budget, for Foundation and corporate grants, which in this instance may reflect that the CAA has received large grant awards that it did not expect when the budget was approved.
- Low percentages such as the 10% in the Events net of expenses which in this instance most likely reflects that the big event has not yet been held. If the CAA used a year-to-date budget rather than an annual budget for comparison, percentage of actual to budget would probably not be so low because the budget would have reflected the timing of the event.

4. Statement of Cash Flows

This statement explains how cash has increased or decreased during the period reported on the Statement of Activities through operations, financing, and investing activities. This statement explains how it is possible for overall cash to decrease during a period in which revenues exceed expenses or increase during a period in which revenues fall short of expenses. This Statement may be particularly helpful to board members who are confused by the accrual accounting method and just want to understand why the agency's cash is increasing or decreasing.

A board member may ask about the following:

- Under Cash Flows From Operating Activities, why have the Accounts receivable increased so significantly? Is the CAA struggling with receiving payments from third parties?

5. Statement of Functional Expenses

This statement is required for CAAs that want to present their financial statements following GAAP accounting principles. It provides a matrix format in which the rows (often referred to as line items) are specific types of expenses (Salaries, Supplies, Rent) and the columns are used to display the cost centers that the CAA uses to distinguish its different functions, management costs, fund raising costs, and different programs. The line item shown in each column reports the portion of the total line-item expense (for example, all Salaries) that provided benefit to that specific cost center (for example Early Childhood Services).

6. Statement of Functional Revenues and Expenses

This statement uses the same matrix format as the Statement of Functional Expenses but adds line items for specific types of revenue (government awards, fees for services, etc.). It displays the sources of income that are used to support the expenses in each distinct function or cost center. It facilitates understanding which cost centers are generating enough income to cover all the costs of providing the services included in that cost center and which cost centers operate at a loss and need to be subsidized by the use of unrestricted funds.

A board member may ask about the following:

- Under the Admin column, what revenue is being used to cover the very large expense ($739,085) listed?
- Under the Fundraising column, should the board revisit its and the CAA's efforts in generating unrestricted revenue?

1. Statement of Financial Position (Balance Sheet)

All Good Things CAA

September 30, 2025

with comparative totals as of June 30, 2025

	9-30-25	6-30-25
Assets		
Cash	$ 160,000	$ 300,000
Receivables	401,100	81,100
Land, buildings, equipment, net	1,500,000	1,510,000
Total assets	**$ 2,061,100**	**$ 1,891,100**
Liabilities and Net Assets		
Liabilities		
Accounts payable	180,000	170,000
Mortgage payable	500,000	500,000
Total liabilities	**680,000**	**670,000**
Net Assets without Donor Restrictions		
Available for operations	31,100	11,100
Invested in fixed assets	1,000,000	1,010,000
Board designated reserves	100,000	100,000
Net assets without donor restrictions	**1,131,100**	**1,121,100**
Net assets with Donor Restrictions	**250,000**	**100,000**
Total Net Assets	**1,381,100**	**1,221,100**
Total liabilities & net assets	**$ 2,061,100**	**$ 1,891,100**

2. Statement of Activities (Columnar)

All Good Things CAA

7/1/25 through 9/30/25

	Without Donor Restrictions	With Donor Restrictions	Total
SUPPORT AND REVENUE			
Foundation and corporate grants	$ 850,000	$ 800,000	$ 1,650,000
Governmental grants & contracts	2,326,000	-	2,326,000
Contributions from individuals	25,000	-	25,000
Events (net of expenses)	8,000	-	8,000
Investment income	3,900	-	3,900
Total unrestricted support and revenue	3,212,900	800,000	4,012,900
Net assets released from restrictions	700,000	(700,000)	-
Total support & revenue	3,912,900	100,000	4,012,900
EXPENSES			
Personnel	3,390,708	-	3,390,708
Prof Services	262,500	-	262,500
Occupancy	198,222	-	198,222
Other expenses	51,470	-	51,470
Total expenses	3,902,900		3,902,900
INCREASE IN NET ASSETS	**10,000**	**100,000**	**110,000**
NET ASSETS, Beginning of Year	1,121,100	100,000	1,221,100
NET ASSETS, End of 1rst Qtr.	$ 1,131,100	$ 200,000	$ 1,331,100

3. Statement of Activities (Stacked)

All Good Things CAA
7/1/25 through 9/30/25

	7/1/25 -- 9/30/25	Annual Budget	% Budget Realized	Projected Year End
Foundation and corporate grants	$ 850,000	$ 300,000	2.83	$ 750,000
Governmental grants & contracts	2,326,000	8,130,000	0.29	8,600,000
Contributions from individuals	25,000	100,000	0.25	100,000
Events net of expenses	8,000	80,000	0.10	40,000
Investment income	3,900	15,000	0.26	15,000
	3,212,900	8,625,000	0.37	9,505,000
Net assets released from restrictions	700,000	1,575,000	0.44	1,575,000
Total support and revenue without donor restrictions	**3,912,900**	**10,200,000**	**0.38**	**11,080,000**
Expenses w/o Donor Restrictions				
Personnel	3,390,708	9,300,000	0.36	10,000,000
Prof Services	262,500	300,000	0.88	300,000
Occupancy	198,222	400,000	0.50	600,000
Other expenses	51,470	175,000	0.29	200,000
Total Expenses w/o donor restrictions	**3,902,900**	**10,175,000**	**0.38**	**11,100,000**
		-		
Increase in Net Assets w/o Restrictions	**10,000**	**25,000**	**0.40**	**(20,000)**
Support with Donor Restrictions				
New Donor Restricted Grants Received	800,000	1,710,000	0.47	1,650,000
Released from Donor Restrict	(700,000)	(1,575,000)	0.44	(1,575,000)
Increase in Net Assets with restrictions	**100,000**	**135,000**	**0.74**	**75,000**
Increase in Total Net Assets	**110,000**	**160,000**	**0.69**	**55,000**
Net Assets, Beginning of Year	**1,221,100**			
Net Assets, End of 1rst Qtr.	**$ 1,331,100**			

4. Statement of Cash Flows

All Good Things CAA

Quarter ended September 30, 2025

	9-30-25
CASH FLOWS FROM OPERATING ACTIVITIES:	
Increase in net assets	$ 160,000
Adjustments to reconcile increase in net assets	
to net cash provided by operating activities:	
Depreciation	10,000
(Increase) decrease in:	
Accounts receivable	(320,000)
Increase (decrease) in:	
Accounts payable	10,000
Net cash provided by operating activities	(140,000)
CASH FLOWS FROM INVESTING ACTIVITIES	
Net cash used in investing activities	-
CASH FLOWS FROM FINANCING ACTIVITIES	
Net cash from financing activities	-
NET INCREASE (DECREASE) IN CASH AND EQUIVALENTS	(140,000)
CASH AND EQUIVALENTS, BEGINNING OF QUARTER	300,000
CASH AND EQUIVALENTS, END OF QUARTER	$ 160,000

5. Statement of Functional Expenses

All Good Things CAA

for the 3 Months - July 1, 2025 through September 30,2025

	7/1/25 thru 9/30/25	Admin	Fundraising	Prog X	Prog Y	Prog Z
Personnel	$ 3,390,708	$ 610,327	$ 203,442	$ 813,770	$ 813,770	$ 949,398
Prof Services	$ 262,500	$ 110,250	$ -	$ -	$ 76,125	$ 76,125
Other expense	$ 198,222	$ 13,876	$ 27,751	$ 23,787	$ 51,538	$ 81,271
Occupancy	$ 51,470	$ 4,632	$ 4,632	$ 26,764	$ 5,147	$ 10,294
Total Expenses	**$ 3,902,900**	**$ 739,085**	**$ 235,826**	**$ 864,321**	**$ 946,580**	**$ 1,117,088**

6. Statement of Functional Revenues and Expenses without Donor Restrictions

All Good Things CAA

July 1, 2025 through September 30,2025

	7/1/25 thru 9/30/25	Admin	Fund Raising	Prog X	Prog Y	Prog Z
Support and Revenues without Donor Restrictions						
Foundation grants	$ 850,000		$ 262,140	$ 7,873	$ 40,000	$ 539,987
Government contracts	2,326,000			1,000,000	1,000,000	326,000
Individual gifts	25,000		25,000			
Events net of expenses	8,000		8,000			
Investment Income	3,900		3,900			
Released from Temp Restrictions	700,000			73,000	128,306	498,694
Total support and revenue without Donor Restrictions	**3,912,900**	**-**	**299,040**	**1,080,873**	**1,168,306**	**1,364,681**
Direct Expenses						
Personnel	3,390,708	610,327	203,442	813,770	813,770	949,398
Prof Services	262,500	110,250	-	-	76,125	76,125
Other expense	198,222	13,876	27,751	23,787	51,538	81,271
Sub-total direct expenses	**3,851,430**	**734,453**	**231,194**	**837,557**	**941,433**	**1,106,794**
Allocated Expenses						
Occupancy	51,470	4,632	4,632	26,764	5,147	10,294
Direct and allocated expenses	**3,902,900**	**739,085**	**235,826**	**864,321**	**946,580**	**1,117,088**
Allocation of administrative expenses	**-**	**(739,085)**	**53,214**	**216,552**	**221,726**	**247,593**
Expenses after allocation of administrative expenses	**3,902,900**	**-**	**289,040**	**1,080,873**	**1,168,306**	**1,364,681**
Excess (deficit) of support & rev over total expenses	**$ 10,000**	**0**	**$ 10,000**	**$ 0**	**$ 0**	**$ (0)**