A Board Member's Guide to Nonprofit Accounting

Dugan + Lopatka

Accounting for What Matters.

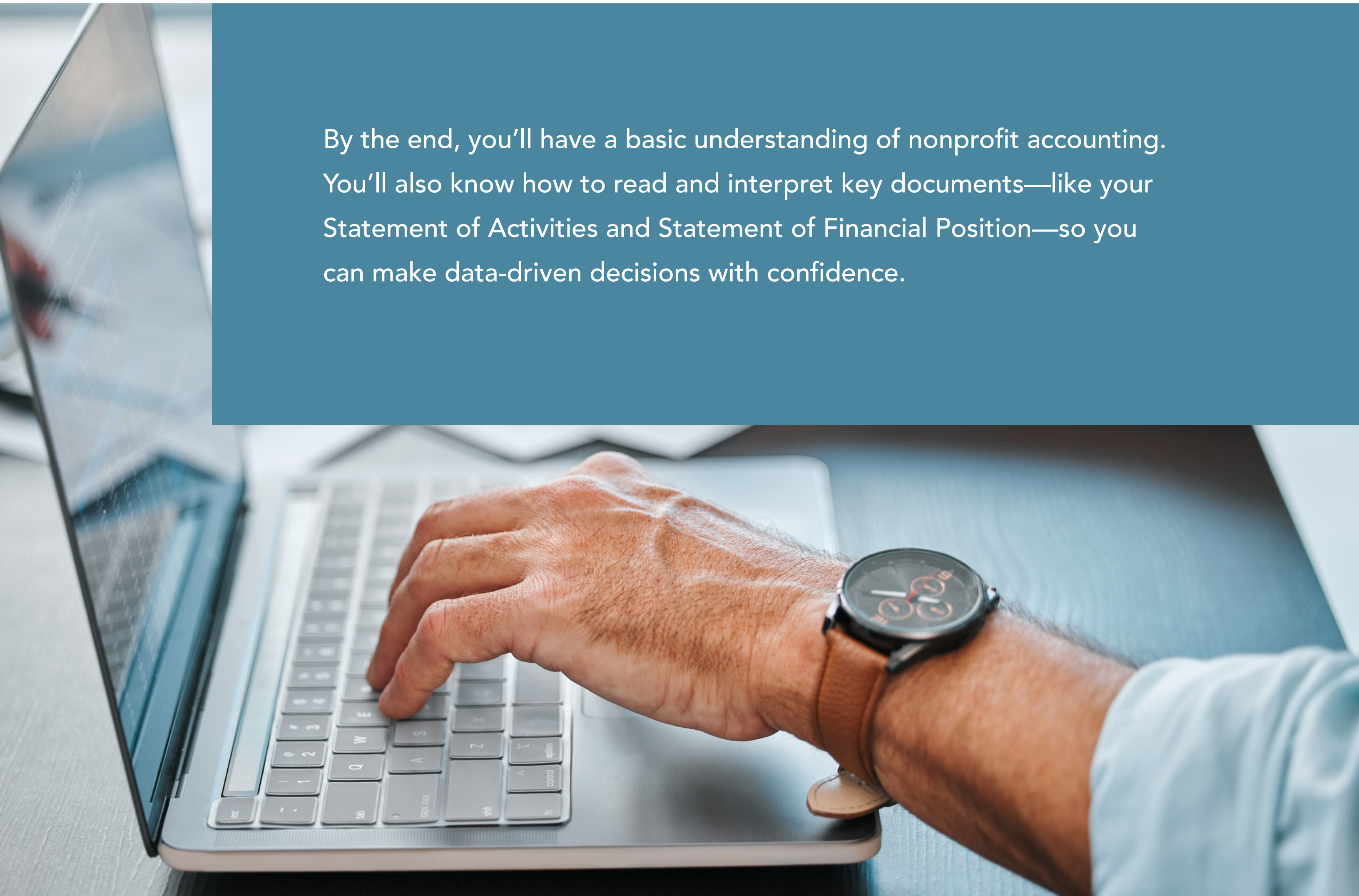
You don’t have to be an accounting expert to be a nonprofit board member.

But you should know the basics.

Finances are an integral part of every tax-exempt organization. As a board member, you really can’t understand how your nonprofit works, or the rationale behind key decisions, until you understand the financials.

That’s what this guide is all about. Over the next few pages, we’ll introduce you to the key accounting terms and concepts that every nonprofit board member should know.

By the end, you’ll have a basic understanding of nonprofit accounting. You’ll also know how to read and interpret key documents—like your Statement of Activities and Statement of Financial Position—so you can make data-driven decisions with confidence.



What's Inside

Part 1

NFP Accounting: 6 Key Concepts

1. The Difference Between For-Profit and Nonprofit Accounting

When it comes to finance, for-profit and nonprofit organizations have a lot in common. For one, they both aim to minimize costs while maximizing revenue (and impact, for nonprofits). Many of the financial statements they produce are similar, and some of the rules that apply to nonprofits apply to for-profits as well. In both sectors, cash is king; private companies and tax-exempt organizations alike are constantly making projections and monitoring their cash flow.

Of course, the sectors also have their differences, starting with their basic goals.

For-Profit Accounting Goals

- Maximize revenue and net profit.
- Minimize overhead.
- Minimize tax liability.

Nonprofit Accounting Goals

- Generate revenue through donations, event proceeds, and grants.
- Minimize overhead costs.
- Maximize impact by investing revenue in programs and services.
- Maintain tax-exempt status.
- Build trust among supporters.

Unlike for-profits, nonprofits don't keep the profits they generate. Instead, it's all reinvested into the mission. Nonprofits usually don't pay taxes—some NFPs have unrelated business taxes or excise taxes. This is obviously a major benefit, but it also means that nonprofits face intense scrutiny from the IRS. They must continuously prove that they are using their funds in a responsible, mission-driven way and complying with regulations. If they don't, they could lose their tax-exempt status. Similarly, donors and other supporters of nonprofits typically keep a close eye on the organization's finances. They want to make sure their money is being used responsibly.

For all the reasons above, good financial management is at the heart of every successful nonprofit. That's why, as a leader, it's critical that you understand the nuances of fiscal management for tax-exempt organizations.

2. Mind the GAAP

Each nonprofit is unique, but every organization must ensure that their accounting complies with the Generally Accepted Accounting Principles (GAAP). These principles ensure that the assets, liabilities, income, and expenses you're reporting are accurate, complete and timely, and that the proper controls are in place.

In short, the ten basic principles of GAAP include:

- **Regularity:** Obeying all relevant rules and regulations.
- **Sincerity:** Only reporting accurate information.
- **Consistency:** Adhering to the same standards across the entire reporting process.
- **Non-Compensation:** Reporting every aspect of your organization's financial performance, including negative information.
- **Prudence:** Refraining from speculation in financial reports.
- **Permanence of Records:** Preserving all key financial data.
- **Continuity:** Assuming the organization will continue operating when evaluating assets.
- **Materiality:** Producing reports that fully reveal the nonprofit's financial status.
- **Periodicity:** Dividing reports into regular periods, such as years or quarters.
- **Good Faith:** Acting honestly and following the GAAP.

3. Why Managing Overhead Matters

Every organization in every industry wants to manage costs. For nonprofits, however, properly balancing your program costs and overhead is essential. Responsible financial management is, of course, a big part of complying with tax-exempt regulations; it also helps you build trust with donors, maximize your impact, and position your organization to receive more grant funding.

To properly manage overhead, your organization should clearly define, track and monitor expenses, while regularly reevaluating these costs. Having proper controls is critical, too. Your organization should also conduct regular audits to ensure expenses are approved and reported according to your guidelines.

4. Managing Payroll & Taxes

Payroll for nonprofits functions almost exactly like for-profit payroll. All the same best practices apply:

You should always set clear salaries and pay rates, comply with applicable labor standards, classify all team members as either independent contractors or employees, file your taxes, and keep clear, detailed records.

Taxes are a different story. To maintain their tax-exempt status, nonprofits must comply with a unique set of requirements when reporting, filing and notifying the IRS.

Before we move on, let's cover one of those compliance requirements: IRS Form 990. In most cases, if your nonprofit receives more than $200,000 in annual revenue, your team must file this form annually. (Smaller organizations can submit Form 990-EZ.)

Form 990 details key information about your organization, including your mission and how your team uses resources to achieve those goals. Filing this form completely and accurately is essential for maintaining tax-exempt status.

5. More Nonprofit Accounting Terms You Should Know

Nonprofit-Specific Accounting Statements

- **Nonprofit Budget Statement:** This provides a detailed overview of how an organization plans to spend its money over a specified period (often 12 months). It includes a detailed breakdown of all operating expenses and other costs.
- **Statement of Activities:** Similar to an Income Statement, this document shows changes in the organization's net assets.
- **Statement of Financial Position:** The nonprofit equivalent of a Balance Sheet, this statement details the organization's assets and liabilities.
- **Cash Flow Statement:** This form details how money moves through the organization, accounting for operating, investing and financing activities.
- **Statement of Functional Expenses:** This doc offers a more in-depth look at a nonprofit's expenses. The Statement of Functional Expenses can help establish greater transparency and build trust with donors.

Basic Budgeting Terms

- **Operating revenue** consists of all income used to fund an organization: grants, donations, program fees, etc.
- **An operating reserve** is a cash reserve that can be tapped if revenues dip or unexpected costs emerge.
- **Program costs** are funds allocated to your organization's mission-driven programs and services.

Part 2

Budgeting Basics

What Is a Nonprofit Budget?

Put simply, a nonprofit budget is a financial plan that forecasts the organization's income and expenses over a specific period, usually one fiscal year. Unlike a for-profit budget, a nonprofit budget focuses on balancing revenue and expenses to fund the organization's mission, rather than maximizing profit.

Why Nonprofit Budgets Matter

With an organized budget, nonprofits can align resources to specific goals, ensuring there's enough funding allocated to support its programs. A budget can provide a financial map that helps leadership make informed decisions, while increasing transparency across the organization.

For donors and stakeholders, a well-managed budget builds trust, demonstrating that funds are being used to make a maximum impact aligned with the organization's mission.

Key Components of a Nonprofit Budget

- **Revenue:** This is the money the organization expects to bring in. Common revenue sources include donations and grants, fundraising events, program fees, and service revenue.
- **Expenses:** These are the anticipated costs of running the nonprofit. The typical expense categories are program expenses, administrative expenses, and fundraising expenses.
- **Net Income (or Surplus):** This is the difference between revenue and expenses. For nonprofits, your net income shows your financial results for a period of time. Any surplus should be reinvested back into the organization.

Types of Nonprofit Budgets

- **Operating Budget:** Covers the organization's expected income and expenses over a specific period (usually a year).
- **Capital Budget:** Used for large, one-time expenses, like buying property or equipment.
- **Program Budget:** Focuses on the finances of individual programs, helping ensure each one has the funds it needs without affecting others.
- **Cash Flow Budget:** Tracks when and how money will be received and spent. This is especially important for organizations that have seasonal income or expenses.

How to Create a Nonprofit Budget

1. **Set Goals:** Align the budget with your organization's mission and strategic goals.
2. **Estimate Income:** Determine possible revenue from grants, donations, program fees, and other sources.
3. **Categorize Expenses:** Break down expenses by category, separating program, administrative, and fundraising costs.
4. **Adjust and Balance:** Verify that the total estimated income equals or exceeds total estimated expenses.
5. **Review and Approve:** Review the budget as a board and confirm that it supports the organization's mission and goals.
6. **Monitor and Adjust:** Once the budget's set, set aside time regularly to review it and account for any changes in income or expenses.

Common Budget Challenges for Nonprofits

Since donations and grants can be unpredictable, having a cash reserve or creating a flexible budget can help your organization manage fluctuations. Many donations or grants can also come with restrictions on how the money can be spent, so it's crucial to track these funds carefully. Then there are unexpected costs: These can strain resources, so it's wise to include a small contingency in the budget for unforeseen expenses.

3 Things to Remember

1. A nonprofit budget is a financial plan that outlines anticipated revenue and expenses and allocates funds towards the organization's goals.
2. Budgeting is a team sport. Be sure to include all board members when drafting and reviewing financial plans.
3. Be flexible and iterative. Your funding and expenses will change, so it's important to regularly review your budget and adapt accordingly.

Part 3

Nonprofit Statement of Activities

A Window into Your Organization's Financial Sustainability

What Is the Nonprofit Statement of Activities?

The Statement of Activities is the nonprofit equivalent of the private sector's income statement: an annual financial report that details your organization's revenue and expenses. The report covers three basic sections—revenue, expenses, and net assets—as well as funds that are with and without donor restriction.

Why Is It Important to Understand Your Statement of Activities?

To stay compliant with Generally Accepted Accounting Principles (GAAP), every nonprofit must compile an annual Statement of Activities. These reports also come in handy during tax time; with your Statement of Activities and Statement of Functional Expenses, your team will have all the data they need to accurately and completely file Form 990.

But compliance is only one reason (admittedly a good one) to compile this report. As a board member, you can use the Statement of Activities to monitor your organization's financial health, determine whether your current expenditures are sustainable, and allocate funds more efficiently.

Revenues	Without Donor Restriction	With Donor Restriction	Total
Individual Donations	$150,000	$50,000	$200,000
Grants	$50,000	$100,000	$150,000
Investment Income	$75,000	$0	$75,000
Other	$0	$0	$0
Total Revenues	**$275,000**	**$150,000**	**$425,000**
Expenses			
Program Services	$160,000	$0	$160,000
General and Administrative	$37,000	$0	$37,000
Fundraising	$38,000	$0	$38,000
Total Expenses	**$235,000**	**$0**	**$235,000**

Let's Break It Down

The Statement of Activities is divided into three vertical columns: revenue, expenses and net assets.

1.) Revenue, AKA income, includes funding from sources like cash contributions, grants, investment returns, non-cash contributions (such as stocks and land), and more. Most revenue is recorded as gross, while investment returns are recorded as net.

2.) Expenses are divided into three categories: administrative, fundraising and program. Program expenses cover your organization's mission-based services. Obviously, nonprofits seek to minimize administrative and fundraising costs while maximizing program impact, so this part of the statement is critical. Administrative (or operational) expenses include any costs associated with running your organization on a day-to-day basis. Fundraising, of course, includes anything to do with raising money: galas, appeals, etc.

3.) Net assets are simply your organization's revenue minus expenses. This section shows how efficiently your organization is running and offers a glimpse into its financial sustainability.

Revenues	Without Donor Restriction	With Donor Restriction	Total
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Investment Income	$75,000	$0	$75,000
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General and Administrative	$37,000	$0	$37,000
Fundraising	$38,000	$0	$38,000
Total Expenses	**$235,000**	**$0**	**$235,000**
Change in Net Assets	$40,000	$150,000	$190,000
Net Assets, Beginning of Year	$4,300	$0	$4,300
Net Assets, End of Period	**$44,300**	**$150,000**	**$194,300**

Revenue With Donor Restrictions vs. Revenue Without Donor Restrictions

In addition to the three categories above, the Statement of Activities also has columns for two types of revenue: with donor restriction and without donor restriction. With donor restriction revenue must be used for a specified purpose, whereas without donor restriction revenue can be allocated at your organization's discretion. (Some revenue may be temporarily with donor restriction. After a given time period, these funds will become without donor restriction.)

Why is this important? Because without donor restriction funds are flexible—they can be reallocated to cover other types of expenses—while with donor restriction funds are not. It's an important factor to consider when measuring your organization's financial stability. Understanding the difference between the two types of revenue can help you prevent cash flow issues and ensure long-term sustainability.

3 Things to Remember

1. The Statement of Activities shows your organization's revenue and expenses over time.
2. As a board member, you can use this report to inform financial decisions and understand your nonprofit's financial sustainability.
3. When analyzing your statement, pay attention to restricted vs. unrestricted revenue. More restriction means less financial flexibility.

Part 4

Statement of Financial Position

A Snapshot of Your Organization's Assets & Liabilities

What is the Statement of Financial Position?

The statement of financial position is one of the core financial statements for nonprofits. It provides a snapshot of the organization's financial health at a specific point in time. Think of it as a list of what the organization owns (assets) and owes (liabilities), as well as its net worth.

Why It's Important to Understand Your Balance Sheet

The statement of financial position gives board members a full picture of the organization's financial stability. By examining the assets, liabilities, and net assets, board members can understand the nonprofit's financial health, funding sources, and operational flexibility.

As a board member, it's important to ask questions about the organization's assets and liabilities, restricted funds, and liquidity. The statement of financial position often holds the answers.

Assets	2018	2019
Cash and Cash Equivalents	$250,000	$240,000
Contributions Receivable	$50,000	$45,000
Prepaid Expenses	$2,000	$1,750
Property and Equipment	$75,000	$75,000
Total Assets	**$377,000**	**$361,750**
Liabilities		
Payables	$125,000	$120,000
Debt	$55,000	$45,000
Other	$15,000	$15,000
Total Liabilities	**$195,000**	**$180,000**
Net Assets		
Without Donor Restrictions	$130,000	$120,000

Let's Break It Down

The Statement of Financial Position is divided into three sections: assets, liabilities and net assets.

1. Assets

- **Current Assets:** These are assets the organization expects to use or convert to cash within a year (i.e. cash, receivables, short-term investments).

- **Non-Current Assets:** Long-term assets that provide value beyond one year, like property, equipment, and investments.

2. Liabilities

- **Current Liabilities:** Debts or obligations the organization needs to pay within the year, such as accounts payable and short-term loans.

- **Non-Current Liabilities:** Longer-term debts, like long-term loans or deferred grants.

3. Net Assets

- **Net Assets Without Donor Restrictions:** These funds are available for any purpose to help the organization fulfill its mission.

- **Net Assets With Donor Restrictions:** Funds that are subject to donor-imposed stipulations. They can be temporary in nature, such as for a specific purpose/program or by time. They can also include restrictions in perpetuity, such as an endowment.

Assets	2018	2019
Cash and Cash Equivalents	$250,000	$240,000
Contributions Receivable	$50,000	$45,000
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Property and Equipment	$75,000	$75,000
Total Assets	**$377,000**	**$361,750**
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Payables	$125,000	$120,000
Debt	$55,000	$45,000
Other	$15,000	$15,000
Total Liabilities	**$195,000**	**$180,000**
Net Assets		
Without Donor Restrictions	$130,000	$120,000
With Donor Restrictions	$52,000	$61,750
Total Net Assets	$182,000	$181,750
Total Liabilities and Net Assets	**$377,00**	**$361,750**

Tips for Reading the Statement of Financial Position

- Focus on trends over time: Comparing statements from multiple periods can reveal patterns.
- Check the liquidity ratio: This indicates how easily the organization can cover immediate and unanticipated expenses.
- Assess the mix of assets and liabilities: A good balance shows financial stability, while an imbalance may require attention.

3 Things to Remember

1. The Statement of Financial Position consists of assets, liabilities, and net assets.
2. When reading the Statement, determine whether your organization's assets outweigh liabilities and how funds are allocated between unrestricted and restricted categories.
3. Compare your current and past reports to identify patterns and trends in your organization's financial status.

Part 5

All About Audits

What Is a Nonprofit Audit?

A nonprofit audit is an independent review of an organization's financial records and practices. Conducted by a CPA, an audit assesses whether the organization's statements are materially accurate and reflect its financial position.

While not all nonprofits are legally required to conduct audits, organizations that receive a significant amount of public funding, state or federal grants, or large donations must conduct regular audits to meet compliance and stakeholder expectations.

Why Audits Matter for Nonprofits

Many grants (especially government-funded grants) require audited financial statements. But even in situations where one's not legally required, an audit can be a valuable exercise.

An audit helps confirm that funds are used responsibly and as intended, which builds trust. Donors, grant-makers, and the public often feel more confident investing in nonprofits that undergo regular audits.

Audits can also reveal financial mismanagement, institutional vulnerabilities, and other areas of improvement.

Other Types of Financial Reviews

Beyond audits, nonprofits can have other types of financial reviews based on their needs and resources. A review is typically less extensive and more affordable than a full audit, offering limited assurance on financial statements. A compilation, meanwhile, involves gathering financial data and putting it into a statement without any assurance.

The Audit Process: What to Expect

1. **Planning:** The auditor meets with the nonprofit's leadership to discuss goals, timelines, and required documents.

3. **Reviewing Transactions:** This involves verifying a sample of transactions, checking documentation, and looking for any irregularities.

3. **Reporting:** The auditor provides a report detailing their findings. This may also include recommendations for improvement.

How to Prepare

Preparation is key to a smooth audit process. As a board member, you can do your part by familiarizing yourself with financial statements, budgets, grant agreements, and donor records. Make sure your nonprofit's financial data and documents are well organized, accurate and accessible.

Auditors will examine your internal controls, so it's important to have policies for handling donations, expenses, and other financial transactions. Of course, don't hesitate to ask the auditors questions to gain a clearer understanding of their findings and recommendations.

3 Things to Remember

1. Audits are an essential tool for transparency and accountability in nonprofit organizations, helping to build donor trust and ensure funds are managed responsibly.

2. Nonprofits may be required to have an audit based on funding sources, and preparing for the process with organized records and strong internal controls is crucial.

3. Board members play an essential role in supporting audits by understanding the process, reviewing findings, and helping implement recommendations.

Accounting for What Matters

At Dugan + Lopatka CPAs, our team has decades of experience working with mid-sized and larger nonprofit clients. We know what matters to you, and our expert CPAs understand how to account for the unique needs of tax-exempt organizations.

Learn more and connect with us at www.duganlopatka.com.

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