NONPROFIT FINANCIAL STATEMENTS

by
Kelly Bourgeois

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Purpose

The purpose of this capstone project is to describe and analyze the significance of select financial statements of nonprofits. By examining a variety of literature and by summarizing material acquired from three capstone courses taken in the Arts and Administration masters program, I will be able to provide recommendations for utilizing financial statements for nonprofit financial management. The significance of this capstone project will be that it provides an analysis of the importance of financial data that is applicable to arts organizations.

Historical Background

Peter Hobkin Hall argues in *Historical Perspectives on Nonprofit Organizations*, that during the colonial period "…neither philanthropy nor voluntary associations existed then in a recognizably modern form" (1994, p.4). Still, colonists supported charitable purposes, with the majority of the money given though donations to public institutions. (Hobkin,1994) "Only in the mid-eighteenth century did the political, economic, and legal conditions favorable to the development of voluntary associations and private philanthropy…assume significance" (Hobkin, p.6).

After 1789, the Constitution viewed donations as contractual relationships to public entities and thus encouraged and supported such contributions. This interpretation of the Constitution encouraged the idea that people had a private responsibility to support the public good.

In 1874, Charles Eliot defended tax exemption of public institutions and broadened the scope of tax-exempt organizations. His arguments also helped increase the size of acceptable tax-exempt gifts (Hobkin, p.10). Charitable institutions grew enormously because of these new regulations. Charitable trusts, community chests, and foundations emerged during the late 19th century and "would substitute for equality of condition, equality of opportunity and, suffused with an ethos of service, would invest social, economic, and political life with a sense of common purpose" (Hobkin, p.17). The number of charitable institutions in the United Sates continued to grow.

World War I demonstrated the importance of private support of the public good through public-private partnerships. The war provided an opportunity for major fundraising and created partnerships between public entities such as the Red Cross and private businessmen such as Herbert Hoover (Hobkin, p.17). Hoover's efforts were based on "voluntary cooperation with the community" which would develop an exchange of information between social organizations, scientific institutions, and economic entities (Hobkin, p.18). Hoover's ideals influenced Roosevelt's formation of the National Recovery Administration, an early New Deal program.

Because of increased taxation modern nonprofits proliferated in the 1930's. Businesses and wealthy citizens now had major incentives to give to organizations. Nevertheless, as Salamon points out," The Great Depression of the 1930s made clear…that private and localized system of aid, however well intentioned, was not capable of providing on its own the protections that an urban-industrial society required" (Salamon, p.58). The New Deal administration therefore enacted a multitude of programs: old-age pensions (Social Security), unemployment insurance, and needs-tested cash assistance (Salamon, p.58). Although these programs represented major steps to providing aid to all citizens, they fell short of intended goals and were characterized by "patchy coverage, limited funding, local and state government dominance, and educational salience" (Salamon, p.59).

During the 1930's changes in economic philosophy, taxes and budgeting practices, foreign policy, legal doctrines, and demographic factors intersected to create a distinctively American version of the welfare state (Hobkin, 1994, p.19). "Keynesian economic theory pointed to the ways in which taxing, spending, and borrowing could be used to influence the economic activities from which the government drew its revenues" (Hobkin, p.19) and encouraged individuals to give money to for-profit and nonprofit activities. In turn, enormous amounts of money were transferred into foundations and nonprofits.

Beginning in the 1940's with the governmental system unable to provide universal assistance because of World War II, the general public turned to nonprofits to play a significant role in the public social welfare system. Legislation passed in 1943 made income taxation universal and created more incentives for the public to give to charitable organizations. (Hobkin, p.19). The government played a role in funding the growth of charitable organizations by giving businesses and individuals additional incentives to give to charitable organizations. The government also provided grants and contracts that stimulated the growth of nonprofits.

The "Great Society" of the 1960's made major strides in social reform including: employment training for the disadvantaged; Medicare, a national health insurance plan for the elderly; Medicaid, health care for the poor; networks of education programs in low-income neighborhoods; and a cost-of-living adjustment added to the Social Security program (Salamon, p.61). In addition, Congress established the National Endowment for the Arts and the National Endowment for the Humanities in 1965. The evolution of the welfare system was characterized by increased spending on middle-class programs such as pensions and health thereafter little aid was provided for low-income people or the poor.

During the 1970's, the continued pattern of patchy coverage still forced the government to look towards the nonprofit sector to provide social services for the general public. Nonprofit organizations thrived in this environment by receiving government aid through various applicable programs such as Medicare, research grants, and local and state government monies.

This growth period was cut short in the 1980's with a new administration that cut education, income assistance, and social service programs and moved social program money into health care, housing, and pension plans. The purpose of this shift in funding was to encourage the growth of nonprofits in areas that had been supported by the government. It actually refocused social services on the middle-class and encouraged for-profit corporations to compete with nonprofits. Nonprofits were able to continue to provide services through into the 1990's through increased health care costs and a boosted demand for services provided by nonprofits paid through business income.

Overall, even with the 1980's retrenchment, government aid to nonprofits increased. Presently, nonprofits continue to receive a majority of their funding through government agencies while facing increased competition from for-profit entities. As the history of nonprofits demonstrates, providing social services for the general public will continually be affected by government policies and the demand for services from the general public. Increased demand with increased competition will force nonprofits to seek private funding and become financial managers.

Background of Financial Statements

In *Financial Accounting and Managerial Control for Nonprofit Organizations* (1994), Regina Herzlinger and Denis Nitterhouse state: "The size of the private nonprofit sector has been pegged at 970,000 nonprofit organizations, with 7.4 million employees and contributions of $104 billion" (p.1). The competition for funds from governmental agencies and foundations has necessitated clarity and consistency in financial statements provided by small nonprofits.

Harrington Bryce argues, "The principle purpose of a nonprofit organization is (1) not to make a profit, and (2) not to benefit individuals as owners, but to advance the welfare of society" (p.3). In short, the principle purpose of a nonprofit is to realize its mission of public service. It must do this within ethical and accountable financial management practices established by the Financial Accounting Standards Board (FASB), the state, and the Internal Revenue Service (IRS). Primarily the organization must produce three important annual financial statements: the statement of financial position (balance sheet), the statement of activities (operating statement), and the statement of cash flow. Together, these reports, along with an evaluation by the chief executive officer, reflect the performance and financial condition of the organization.

The balance sheet, or statement of financial position, is a snapshot of the organization's financial condition on a particular date. The balance sheet shows the assets versus the liabilities of the organization and documents the organization's net assets (or what the organization has left after you subtract the liabilities from the assets). At a minimum, the balance sheet must break down the net assets into unrestricted, temporarily restricted, and permanently restricted assets.

In contrast, the income statement, or statement of activities, summarizes the financial activities over a period of time. The income statement addresses how the organization's net assets, of three categories mentioned above, have changed and whether there were times when one net asset class moved in relation to another. As Thomas Wolf argues in *Managing a Nonprofit in the Twenty-First Century*, **"**Armed with the income statement…it is possible to determine whether the organization had a surplus, a deficit, made any unusually large expenditures, or had any revenue windfalls" (1999, p.215).

Finally, the statement of cash flows reports how the organization's cash position changed during the year. In essence, the statement of cash flows provides information about cash receipts and cash disbursements of the organization (Hummel, p.78).

The three financial statements are used together to project and analyze the fiscal health of an organization. Many states and funding organizations require nonprofits to provide these financial statements to address questions about their financial activities. The financial statements may also be used to compile a formal audited statement, prepared by a certified public accountant, that complies with FASB standards.

Analysis of Financial Statements

This analysis will provide examples of internal and external vulnerabilities indicated through the financial statements, future improvements that could be made to increase financial stability using budgets, and the vital that role the three documents play in the health of a nonprofit organization.

The difference in analyzing a nonprofit's balance sheet and a for-profit's balance sheet is the reporting of the organization's equity. Equity derives from the nonprofit's generated earnings from its operations compared to what the organizations owes (Thomas, 1994, p.405). Earnings retained are recorded as net assets or fund balance. In general, the more net assets an organization has retained the greater the organization's net worth (Cumfer, C.& Sohl, K., 2001, p.519). This paper will analyze issues arising from organization's negative or positive net worth. The analysis will also provide information on fund accounting or the breakdown of net assets into unrestricted net assets, permanently restricted net assets, and temporarily restricted assets. The analysis of the income statement will discuss the ratio of expenses during a given period of time to the projected or budgeted expenses during the same period of time. As argued by John C. Thomas in *The Jossey-Bass Handbook of Nonprofit Leadership and Management*, the income statement "explains the change in operating equity between two balance sheets"(1994, p.406). This information can enable the organization to determine if projects, programs, or other unforeseen expenses incurred have affected the organization as a whole. Analysis of the cash flow statement allows organizations to gather information on the income and expense management of the organization.

An organization can determine if net income and net assets are accurate at the end of the year by analyzing the statement of cash flow to determine if there are any unpaid expenses or if revenue will be generated at a later date. In addition, by analyzing the unpaid expenses, an organization can budget appropriately for the given financial period (Olenick, A. & Olenick, P., 1991, p.136).

Significance

As Joan Hummel states in *Starting and Running a Nonprofit Organization* (1996), "Increasingly, funders, government bodies, and various auditing agents are requiring that the organizations they audit follow program accounting methods"(p.76). Nonprofit organizations dependent on federal and state governments are required to have financial verification and established accounting procedures to receive monies from such agencies (Grobman, p.113, 2002). Constituencies dependent on nonprofit organizations' programs are also affected by consistent, detailed record keeping of financial statements that indicate the costs of services and programs provided by an organization. Through cost analysis, nonprofits can make plans to provide more effective services and programs, or conversely, decide to cut services and programs because of the costs involved. In essence, good financial record keeping affects not only the internal aspects of the organization but also external partnerships.

Unfortunately, the contributions to and development of nonprofits are often hindered by the public perception of inadequate and unreliable quantitative and qualitative measures of an organization's success. Lester Salamon states, "…nonprofit organizations generally lack meaningful bases for demonstrating the value of what they do" (p.174). One way to provide reliable and adequate data is through the three detailed financial statements described above.

The key questions that this paper will address through information provided by the three capstone courses and literature review are: What are the fundamental financial statements? What elements compose these statements? How does one analyze information provided by these statements? What are the impacts of each statement?

Assumptions

This analysis assumes the following:

- Financial managers of nonprofits want to understand the financial process of developing and evaluating financial statements.
- Financial accountability is key to successful management of a nonprofit organization.

- The cash flow, income, and balance sheet are three key financial statements of a nonprofit organization.
- Nonprofit managers use financial statements to determine income, expenses, assets, and liabilities of an organization.
- Financial statements are utilized to complete grant applications, state and federal forms.
- Leaders of smaller organizations need to understand and develop financial statements and cannot afford to have full-time technical/professional staff to facilitate financial management.
- Nonprofits will continue to develop and use financial statements to facilitate the mission, goals and objectives of the organization.
- Nonprofit managers will follow accounting principles and have high ethical standards.

Accounting Methods

There are three types of major accounting methods for nonprofits: cash basis accounting, accrual-based, and a modified cash accounting system (Dreezen, C. & Korza, P., 1998, p.246). To determine which accounting method is used by a nonprofit, the organization must first choose to show when revenues or expenses will be recorded and then determine which system will reflect the financial condition of the organization in a more accurate manner.

Most people are familiar with cash basis accounting because it is synonymous with their own checking and savings account. When following a cash basis accounting system "financial transactions are recorded only when cash changes hands" (Wolf, 1990, p.170).

As Thomas Wolf explains: “When a person receives money and deposits it in the bank, the deposit is recorded as income and is added to the bank account balance. [Inversely], when cash is withdrawn from the bank…the transaction is recorded as an expense” (Wolf, p.170). In cash basis accounting receivables and payables are not recorded. Although this system of accounting is quite straightforward it often results in misleading financial information because it tells nothing about what the organization may owe or is owed during a given period of time. Arnold and Philip Olenick argue in *A Nonprofit Organizations Operating Manual* (1991), “The only good argument for recording and reporting economic events only when cash is immediately involved (cash basis) is its familiarity and simplicity” (p.217).

The second form of accounting is the accrual-based accounting method. The accrual method is not as simplistic as cash basis accounting but it does “paint” a picture of the overall financial health of the nonprofit. Accrual method accounting takes into account “all committed income and expenses, whether or not they have been actually received or paid, are entered in the books” (Dreeszen, C. & Korza, P., 1998, p.246). Most people are familiar with the accrual method of accounting because it is synonymous with credit-card transactions and payments. The system of recording not only what has been purchased and paid for but also what is owed to the credit card company is a simplified version of accrual accounting.

Grants are typically entered into the accrual system of accounting as income once a confirmation of the grant is received. The organization may not actually have the money in their account but will receive the money at a later date and therefore can record the grant as income. On the other hand, expenses will be recorded in the same fashion as accounts payable and will reflect the actual amount owed at a given time and will include all activities of the organization not just cash transactions. “The accrual basis classifies revenues and expenses by taking into account not only the accounting period in which the bill is paid, but more importantly, the period in which the activity involved occurred” (Olenick, A. & Olenick, P., 1991, p. 219). With the accrual method specific revenues and expenses are recognized as a current, accrued, or deferred revenue or expense. Arnold and Philip Olenick have provided a synopsis of revenues and expenses and the classification used to identify each type:

1) Current revenue or expense, if all of it was earned or incurred as well as used during the current period and the amount was all paid for in the current period.
2) Accrued revenue or expense, if earned or incurred in the current period, which benefited, to the extent not paid by the end of the period.
3) Deferred revenue or prepaid expense, to the extent paid in advance during the current period, where all or part of it will benefit a future period (1991, p.219).

An example of current revenue is money exchanged for a ticket to a play. The revenue generated from this transaction is considered current revenue because the ticket is used for tonight’s play. Therefore, the revenue and expense happened within the same accounting period. Accrued revenue, on the other hand, might be dues or subscriptions where the amounts remain uncollected after related services have been performed. Often accrued revenue is linked to delinquent accounts, uncollected grants, and program service fees for which the client has not paid for the service that have been performed. Finally, an example of deferred revenue is when pledges, dues or subscriptions are received in advance and specified to be used during a future period. Pledges are accrued and deferred during the period not in use and amortized over the period in which it applies.

A third accounting method is the modified cash basis of accounting. “According to this system, the books are kept on a cash basis except for a few accounts that are kept on accrual and that are usually updated only at the end of the month or at financial reporting time” (Wolf, 1991, p.171). Often the accrual accounts in the modified cash accounting are reoccurring or important outstanding obligations of the organizations. Many organizations use the modified cash basis of accounting to “rectify” their bookkeeping entries to reflect that actual revenues and expenses of the organization and to create an opportunity to summarize financial statements in an accrual method.

To avoid accounting problems, a nonprofit must review the entire organization as a whole and implement an accounting program suited to its individual needs. To do this an organization must address five questions: What personnel are responsible for each duty? What are the safety mechanisms in place for the organization’s resources? What approval and authorization systems are needed or are in operation? What methods are available to verify the safeguards? Does the organization have any insurance to cover losses? (Wolf, 1991, p. 174) (Olenick, A. & Olenick, P., 1991, p. 236-39) The organization must also look at the size and scope of the organization’s activities. As Arnold and Philip Olenick argue, “Different kinds of users differ in their level of expertise, knowledge, and understanding, and in their specific information needs” (1991, p.216). Finally, an organization should determine its accounting purposes at the various levels.

Choosing a type of accounting system for a nonprofit can be a difficult and vexing task. A nonprofit must remember that if it chooses to use a modified or strictly cash basis accounting method that at least once a year the system must be modified to an accrual method. (Wolf, 1991, p. 172) This modification must take place to reflect the financial solvency of the entire organization and its activities. The accrual method is mandated by the generally accepted accounting procedures or GAAP. As Thomas Wolf states, “It should be obvious that knowing the financial condition of an organization is more revealing than knowing its bank balance” (1998, p.171).

Each accounting method has advantages and disadvantages for its use by a nonprofit. An organization should always seek the help of professionals to assist it in implementing and, if possible, administrating its accounts. In the end, the best system is a system that gives the members of an organization control over its financial health and portrays this health through their records. Craig Dreeszen and Pam Korza caution “…picture yourself at audit time trying to explain how money was spent and where money came from” (1998, p.247).

Each component of a nonprofit organization’s existence, such as the organization’s programs and projects, is dependent on the organization’s financial feasibility. Financial feasibly is accounted for through a variety of financial statements, primarily the balance sheet, cash flow and operating statement. One of the principle differences in nonprofit financial statements compared to for-profit entities is that the overall objective of a nonprofit is to realize its socially desirable goals and objectives for the community it serves, rather than to realize a net profit.

Nonprofits can only serve their goals and objectives if they have sufficient cash to provide for various programs. This dependence upon cash flow has created a heavy responsibility for nonprofits to account for the resources they have received. Nonprofit fund accounting has enabled organizations to segregate assets into categories by the restrictions placed on their use. Dreeszen and Korza state, "Unlike the systems used by for-profit corporations in which "owner equity" is shown, a nonprofit tax-exempt entity reports a fund balance on its balance sheet" (1998, p.245). Other differences include: fixed assets may not be recorded by a nonprofit; pledges, contributions, and other noncash contributions can be legally enforceable and recorded as an asset if the organization chooses to collect them; and smaller nonprofits can choose to use the cash basis accounting instead of the accrual method (Connors, 1993, p.789). These differences reflect the unique nature of formulating financial statements for nonprofits and enable nonprofits to manage their assets and record them in an accurate and understandable manner.

When assessing the financial health of a nonprofit, the executive director and board are responsible for overseeing that the organization's financial records are maintained completely and appropriately and clearly state what has happened during a given period of time. Tracy Daniel Connors argues that financial statements should have five characteristics:

1. They should be easily comprehensible so that any person taking the time to study them will understand the financial picture.
2. They should be concise so that the person studying them will not get lost in detail.
3. They should be all-inclusive in scope and should embrace all activities of the organization. If there are two or three funds, the statements should clearly show the relationship among the funds without a lot of confusing detail involving transfers and appropriations.

4. They should have a focal point for comparison so that a person reading them will have some basis for making a judgment. In most instances, this will be a comparison with a budget or with figures from the corresponding period of the previous year.
5. They should be prepared on a timely basis. The longer the delay after the end of the period, the longer the period before corrective action can be taken (1993, p.766).

In addition, statements should reflect the organization's position as accurately as possible. Miscellaneous or small line items should not be grouped together into a "slush" account, which can cause confusion and mislead others when reviewing the statements.

Cash Flow Worksheet and Statement

A cash flow worksheet can aid an organization by reviewing what monetary inflows and outflows the organization will sustain during a given period of time. Rather than revenues and expenses a cash flow worksheet records line items as receipts and disbursements. Specifically, the cash flow worksheet can help an organization determine whether there is adequate cash available for an organization to meet its expenses during the month. The difference between an annual budget and a cash flow worksheet is that the cash budgeted in the worksheet addresses expenses that need to be met during a given month. An annual budget is not concerned with the specific time of the expenses but rather the expenses over the entire year.

By projecting inflows and outflows of cash an organization can determine if there will be a cash flow problem over several months. In the example of the ABC Nonprofit Cash Flow Worksheet, October and November have a surplus of cash. However, by projecting the cash flow of the organization over four months the organization can tell that it will sustain a deficit in December and January. In addition, the organization can spot certain areas that are causing the deficit such as the loss of revenues from grants and the increased expenses incurred in November for rent. These are just two examples of why ABC Nonprofits is projecting a deficit in cash during December.

Cash Flow Worksheet for ABC Nonprofit
10/01/03 to 1/31/04

	October	November	December	January
Opening Cash	**500**	**7,300**	**5,000**	**-1,020**
Expected Receipts				
Client Fees	250	300	300	300
Meyer Grant	2,000	1,000	1,000	0
Government Grant	1,000	0	0	0
Sales	1,500	2,000	2,000	1,500
Donations	3,000	2,500	2,000	1,500
Other Grants	5,000	3,000	0	0
Receipts Total	12,750	6,300	3,300	3,300
Loans Received	0	0	0	0
Total Cash Available	13,250	13,600	8,330	2,280
Expected Disbursements				
Net Payroll	2,000	3,000	3,200	3,000
Federal Withholding &FICA	700	1,000	1,100	1,000
Sate Withholding	300	500	6,00	500
Workers Compensation	250	400	450	400
Unemployment	250	300	450	400
Health Plan	400	500	800	700
Rent	600	1,200	1,200	1,200
Utilities	250	500	800	700
Office Supplies	200	300	200	100
Insurance	300	400	400	400
Postage	200	300	300	200
Program Supplies	300	400	100	200
Printing	100	100	250	100
Other	100	200	300	0
Loan Repayments	0	0	0	0
Total Disbursements	5,950	7,900	8,950	7,700
Ending Cash	7,300	5,000	-1,020	-6,620

A cash flow statement, simply put, enables a nonprofit to determine where it spent its money and where the money came from. The cash flow statement reviews "(1) the net effect of operations (revenues minus expenses), i.e. the operating surplus…(2) non-revenue funds received, such as loans and advances; (3) non-expense items paid, such as payments on loans or installments, or for inventory, prepaid expense, equipment, or security deposits; (4) changes in accounts receivable and accounts payable balances" (Olenick, A. & Olenick, P., (1991), p. 372). The cash flow statement is different from an operating statement because it reflects the cash situation of the organization in its entirety, whereas the operating statement reflects a current given period of an organization's activities as reflected by their revenues and expenses.

The cash flow statement, also called the *Statement of Activity* provides vital organizational information as Robert Anthony and David Young point out:

> Revenues and Expenses are measured by what is called the accrual concept. According to this concept, revenues is recorded when it its earned, and expenses are recorded when they are incurred. These are not necessarily the same as the amount of cash received or paid out. Because of this, entities prepare a third statement—the statement of cash flows (SCF)—that explains the reasons for cash changes. The SCF classifies cash changes into three categories: operations, financing, and investing (1994, p.406).

Cash flow statements can easily be prepared by analyzing the beginning balance sheet with the ending balance sheet of a specific period. Subtracting the beginning balance sheet from the ending balance sheet will indicate the changes in the balances for each period or the cash flow for the organization. Cash or gifts of any kind with a restricted purpose must be segregated from those that are general or unrestricted assets and temporarily restricted funds.

Example of Cash Flow Statement for BookGood Nonprofit**

Cash Flow from Operating Activities:	
Cash Received from Unrestricted:	$ 400,000.00
Temporarily restricted Contributors:	$ 400,000.00
Cash Received from Service Recipients:	$ 30,000.00
Grants Paid:	$ (100,000.00)
Cash paid to Employees and Supplies:	$ (700,000.00)
Interest Paid:	$ (13,000.00)
Interest and Dividends Received:	$ 25,000.00
Net Cash from Operating Activities:	**$ 42,000.00**
Cash Flows from Investing Activities:	
Purchase of Investments:	$ (30,000.00)
Fixed Asset Purchases:	$ (150,000.00)
Net Cash Used for Investing Activities:	**$ (180,000.00)**
Cash Flows from Financing Activities:	
Addition to Endowment:	$ 45,000.00
Issuance of Long Term Debt:	$ 150,000.00
Net Cash from Financing Activities:	**$ 195,000.00**
Net Increase in Cash:	$ 57,000.00
Beginning Cash Balance:	$ 150,000.00
Ending Cash Balance:	**$ 207,000.00**
Reconciliation of change in net assets to net cash Provided by operating activities	
Change in Net Assets:	**$ 100,000.00**
Adjustments	
Depreciation Expense:	$ 3,000.00
Restricted Contributions to Endowment:	$ (30,000.00)
Increase in Pledges Receivable:	$ (45,000.00)
Increase in Refundable Advances:	$ 10,000.00
Increase in Grants Payable:	$ 20,000.00
Decrease In Accounts Payable:	$ (7,000.00)
Increase in Prepaid Expenses:	$ (2,000.00)
Unrealized Gains in Long-Term Investments:	$ (8,000.00)
Net Cash Provided by Operations:	**$ 41,000.00**

******Each of the areas is described below.

Cash Flows from Operating Activities. The area details the unrestricted and temporarily restricted funding of the organization. This includes unrestricted and temporarily restricted cash inflows and outflows. The main body of the ABC Nonprofit cash flow statement is an example of the direct method of accounting that restates the temporarily and unrestricted income on a cash basis. The reconciliation at the bottom of the figure is an example of the indirect method of accounting. This method begins with the change in net assets from the Statement of Activities (Income Statement or Operating Statement) and converts the amounts from the accrual method to cash basis accounting. Most nonprofits will utilize the indirect format to depict the organization cash.

Cash Flows from Investing Activities. This area depicts the cash inflows and outflows that arise from long-term assets and investments.

Cash Flows from Financing Activities. This area depicts the organization's cash inflows and outflows from financing activities such as receipts and repayments to creditors or donors. This area is for permanently restricted funds that have a set of requirements that need to be completed by the organization before the money may be used.

When and organization completes the three sections of the cash flow statement the net increase/decrease in income explains how the cash has changed during the given period of time and shows the current organizations current cash balance.

Balance Sheet

The organization's balance sheet is one of the most fundamentally important documents a nonprofit can provide for use in its internal management. The balance sheet establishes financial information to external entities. The balance sheet is often referred to as the *Statement of Financial Position* or *Statement of Financial Condition.*

The balance sheet complements the cash flow statement because "the cash flow statement tells us what funds we expect to have on hand to pay bills and other obligations as they come due. . . the balance sheet report[s]...its current financial situation" (Olenick, A. & Olenick, P., 1991,p.352). In other words, the balance sheet describes what you own, such as equipment and cash (assets), compared to what you owe, such as loans (liabilities). As argued by Elizabeth K. Keating in *How to Assess Nonprofit Financial Performance*, "The accounting system for nonprofits is designed to capture the economic activities of the firm and its financial position. The financial statements are constructed based on the 'Accounting Equation' in which: Assets = Liabilities + Net Assets" (1991, p.21). The difference between the assets and the liabilities provides information on the organization's net assets.

Management can scrutinize several areas on a balance sheet:

Assets

- The organization's fixed assets such as land, buildings, vehicles, furniture, and equipment
- Inventory (including supplies and merchandise)
- Expenses paid in advance for future service or prepaid expenses
- Cash balance on the date of the balance sheet
- Amounts due to the organization or receivables
- Investments
- Other assets such as security deposits, utilities, etc.

(Olenick, A. & Olenick, P., 1991, p. 353).

Liabilities

- Amounts owed for services rendered or accrued expenses
- Accounts payable, such as goods received from a supplier

- Payments (installments) for equipment
- Taxes payable
- Loans such as short- or-long-term loans
- Unearned revenue such as payments received for services that have not been performed
- Other liabilities such as mortgages (Olenick, A. & Olenick, P., 1991, p. 353).

Once an organization has reviewed the items listed above, it can address several important areas: solvency, resources, and outstanding liabilities. The organization is solvent if the current assets are greater than the current liabilities. A good rule of thumb is to maintain a current ratio of 2:1, assets to liabilities. If liabilities are greater than assets, the organization could face or has faced severe financial problems.

The second step in reviewing the balance sheet should be to look at the resources owned by the organization. By reviewing its resources, management can determine if there are any assets that could potentially be used to supplement the payment of maturing debts.

Finally, management should look at what the organization owes and determine when these outstanding liabilities are due. The most common types of liabilities for an organization come from accounts payable, grants payable, refundable advances, dues to third parties, long-term debt, unrestricted assets, temporarily restricted assets, and permanently restricted assets (Keating, 1991, p.30-31).

Balance Sheet for ABC Nonprofit**

Assets	**% Per Year***	**Year 2000**	**% Per Year***	**Year 2001**
Short Term Assets				
Cash	24.4	$100,000.00	15.63	$ 75,000.00
Pledges Receivable	18.29	$75,000.00	10.42	$ 50,000.00
Prepaid Expenses	2.44	$10,000.00	1.04	$ 5,000.00
Long Term Assets				

Investments	12.19	$50,000.00	41.67	$ 200,000.00
Fixed Assets	42.6	$175,000.00	31.25	$ 150,000.00
Total Assets		$410,000.00		$ 480,000.00
Liabilities and Net Assets				
Liabilities				
Short-term Liabilities				
Accounts Payable	20.9	$37,000.00	27.13	$ 35,000.00
Grants Payable	14.12	$25,000.00	18.6	$ 24,000.00
Refundable Advances	8.5	$15,000.00	7.75	$ 10,000.00
Long-term Liabilities				
Long Term Debt	56.5	$100,000.00	46.51	$ 60,000.00
Total Liabilities	43.17	$177,000.00	26.87	$ 129,000.00
Net Assets				
Unrestricted	42.92	$100,000.00	42.76	$ 150,000.00
Temporarily Restricted	14.16	$33,000.00	14.53	$ 51,000.00
Permanently Restricted	42.92	$100,000.00	42.74	$ 150,000.00
Total Net Assets	56.83	$233,000.00	73.13	$ 351,000.00
Total Liabilities and Net Assets		$410,000.00		$ 480,000.00

*An organization would not include percent of year. This is an example of an internal balance sheet that allows the organization to look at what percentage of assets and liabilities are going to each line-item.
**Each of these areas is described below on the balance sheet.

Balance Sheet Assets

Cash. Liquid funds or funds such as U.S. Treasury bonds on deposit in the bank. An audited financial statement requires that restricted cash (or any other asset) with a donor-imposed restriction which limits its long-term use must be classified in a temporarily restricted or permanently restricted account.

Pledges or grants receivable. These are amounts that have been committed by an outside or external donor to the organization. Pledges and grants should be recorded as the amount the nonprofit expects to receive or the net realized value. Nonprofits should not report the full or gross amount because the line item could be overstated.

Prepaid expenses. These are costs paid in advance for receiving goods, services, or benefits for the organization. This type of asset will decline in value as the asset is consumed by the organization.

Investments. The refers to valuation of the organization's stocks and bonds. The amount that should be recorded is the fair market value on the date that the financial statements are prepared. However, on a tax return, this can the amount can be the historical cost of the investments, the lower fair market value or historical cost, or the normal fair market value that is indicated on the financial statements.

Fixed assets. This category includes all property and equipment owned by the organization. Fixed assets are generally not sold and the balance sheet does not reflect the fair market value of the asset or the cost of replacing the items. Instead, the fixed asset line item includes the net book value of the assets. The net book value is the historical cost of the long-term assets less depreciation. In general, fixed assets depreciate year to year because the organization must record a non-cash depreciation expense. This depreciation often follows the straight-line method, which reduces the asset's worth by equal annual increments over the estimated life of the asset. (Keating, 2001, p.32)

Some nonprofits own works of art. Since these assets may not decline in value, a nonprofit must record them as assets on the organization's balance sheet. Nonprofits can choose to capitalize their collections retroactively, and then depreciation need not be taken because the asset will not be consumed over time. (Olenick, A. & Olenick, P., (1991), p. 352-56).

Balance Sheet Liabilities

Accounts payable. This line item includes unpaid bills from vendors and creditors for goods and services delivered. If specific items such as wages, taxes, and grants are significantly large, they can be reported separately or integrated into this line item.

Grants payable. These are grant amounts promised to individuals or other organizations.

Refundable advances. This is also known as deferred revenue. Included in this line item are grants received from donors that are not considered or recognized as revenue because the conditions of the grant have not been met.

Dues to third parties. These are dues transferred to a third party through another organization. An example is United Way, a federated membership organization which acts as a transfer agent collecting contributions from one group and disbursing the funds to a third party. The intermediary party has no power to change the recipient of the funds, so the funds are considered liabilities.

Long term debt. This is the principal and interest owed to a creditor. Examples of long-term debt are bank loans, publicly traded bonds, or privately arranged debt financing.

Net Assets (Three categories)

Unrestricted. These are funds unrestricted by the donor.

Temporarily restricted. These are funds that are limited by donor stipulations. These stipulations can either be met by the actions of the organization or expire over time.

Permanently restricted. These funds are similar to temporarily restricted funds, but the donor stipulations do not expire over time or by the actions of an organization. An example of permanently restricted funds is the principle of an endowment. The principle of the endowment must remain intact into perpetuity (Keating, 2001, p.32).

Operating Statement

A complete set of financial statements includes a third report called the *Statement of Activity, Income Statement or Operating Statement.* The operating statement is it a description of how the organization's net assets or operations have changed over time. This change in net assets is expressed through the general equation: Revenues – Expenses = Change in Net Assets (Keating, 1991, p.34). This change in net assets reflects either a surplus or a deficit.

The operating statement is generally divided into three categories unrestricted, temporarily restricted, and permanently restricted funds. When an organization receives funds, or revenues it must then determine the intent of the donor, which is then reflected and categorized under unrestricted, temporarily restricted, or permanently restricted funds (Olenick, A. & Olenick, P., 1991, p. 356-58). If a donor imposes a restriction on the funds the use of the funds are limited. However, the donor cannot ask for the return of the donation. An asset can be moved from the temporarily restricted column if the restriction is removed. The asset can then be considered unrestricted and an organization can use the funds appropriately. As indicated on the operating statement below, $100,000 were released from the temporarily restricted fund and moved to the unrestricted category. This change was recorded to indicate that the money was placed in the correct fund and that the temporary restrictions had been met by the organization. This allowed it to move the money to the unrestricted column. Permanently restricted funds cannot be moved unless the time allotted for the funds expires or the full intent of the donor is carried out by the organization.

A donor may also impose a condition when donating monies. A donation is considered a liability until the condition is met as the donor requested. The money is considered a liability because the donation can be rescinded until the condition is met by the organization. It cannot record the donation as revenue until the condition or liability is eliminated. For example, as seen below, the organization will record the $30,000 permanently restricted funds as a liability on the balance sheet because the conditions of the donations have not been met by the organization.

Example of an Operating Statement: Operating Statement/Statement of Activities for ABC Company for Year Ending 2002**

Changes in Unrestricted Net Assets:	**Unrestricted**	**Temporarily Restricted**	**Permanently Restricted**	**Total**
Revenues and Gains:				
Public Contributions (net):	$ 600,000.00	$150,000.00	$30,000.00	$ 780,000.00
Program Service Revenue:	$ 50,000.00			$ 50,000.00
Investment Income:	$ 30,000.00	$5,000.00		$ 35,000.00
Net Assets Released from Restrictions:	$ 100,000.00	$(100,000.00)		**$ 0**
Total Revenues, Gains, Other Support:	**$ 780,000.00**	**$55,000.00**	**$30,000.00**	**$ 865,000.00**
Expenses:				
Program Services:	$ 500,000.00			$ 500,000.00
General Administration:	$ 165,000.00			$ 165,000.00
Fundraising:	$ 100,000.00			$ 100,000.00
Total Expenses and Losses:	**$ 765,000.00**			**$ 765,000.00**
Increase in Net Assets:	**$ 15,000.00**	**$55,000.00**	**$30,000.00**	**$ 100,000.00**
Net Assets as Beginning of Year:	$ 300,000.00	$0	$500,000.00	$ 800,000.00
Net Assets as End of Year:	**$ 315,000.00**	**$ 55,000.00**	**$ 530,000.00**	**$ 900,000.00**

**Each of the line items on the Operating Statement is described below.

Operating Statement Revenues

Contributions. These are unconditional transfers of assets to a nonprofit, cancellation of a liability or settlement of a voluntary nonreciprocal transfer. This line item can include future unconditional promises to pay cash or other assets.

Contributions are recorded at fair-market value when the gift is received. If contributions are paid in installments, the nonprofit can record only the discounted amount given, not the gross amount of the gift. The interest compounded over the length of the gift can be recorded as a gift to the organization. If the organization fears delinquency of payments, the organization can reduce the value of amount given by the anticipated defaults of payments. In-kind goods and services are not generally recorded on the Operating Statement. Collections do not have to be recorded under revenues in certain situations, but in-kind professional services can be recorded if the service increases or creates a non-financial asset.

Program service revenue. This is revenue generated when a nonprofit provides a service in exchange for cash or another asset.

Membership dues. These are fees or revenue that is generated from members of an organization for services that the nonprofit provides.

Special events revenue. This is revenue from special events (i.e. fundraising events) that are recorded separately from contributions. A nonprofit should record the gross revenue of the event and offset this amount by recording the costs associated under the line item for fundraising expenses.

Investment income. This is income earned from the investment portfolio. This includesdividends on stock as well as interest on bonds. GAAP accounting requires that investment income includes changes in the market value of the investments.

Operating Statement Expenses

Program expenses. These are costs for the delivery of goods and services that are associated with the organization's mission.

Fundraising expenses. These are costs associated with publicizing and conducting fundraising campaigns. These may include: maintaining donor mailing lists, conducting special fund-raising events, preparing and distributing fund-raising manuals, and other activities involved in soliciting contributions or memberships.

Administrative expenses. These are costs associated with general and managerial expenses such as oversight, business management, record keeping, budgeting, financing and related administrative activities.

Budgets

A budget shows an organization's projected expenses and revenues for a given period of time. Basic budgeting should be integrated into the organization's programs and service to determine planning steps, evaluation methods, pricing for services, timing of events, and costs related to achieving the organization's mission. Arnold and Philip Olenick argue that there are five key steps in budgeting:

1. Expenses are commonly estimated first. This is the simple process of multiplying the number of people, quantity of supplies, amount of space needed, etc., by the estimated cost per unit of each such item. Normally, the staff that is the most familiar with the details handles this process. A tentative expense budget should then be submitted to the board for review and approval.
2. Potential sources of income are estimated next. People involved in fundraising including the board best accomplish this. Sources may include: grants, fund drives, and fees for service, among others.
3. Expenses must be brought into line with reality. An organization must balance projected income and outgo before a balanced budget can be written.
4. The final proposed budget must then be reviewed and approved by the board after fine-tuning.

5. During the year the budget must be evaluated periodically to determine whether projected and actual income and expenses are in line. If not, and if the variance (amounts over or under budget) are substantial the budget must be updated and revised if it is to be of any use at all (1991, p.83-84).

Estimating revenues for an organization can begin with a general list of the most common types of income. Dues, individual contributions, and investment income can be determined by breaking down the total spent on each line per quarter. In estimating for the upcoming year an organization should factor in the economic climate and the organization's anticipated programs. Projected revenue from fees and admissions can be figured by reflecting on last year's purchasing patterns. A nonprofit should review the changes of price and activity in determining the projected revenue from fees and admissions. As Arnold and Philip Olenick state: "The heart of budgetary control is studying and investigating the cause of variances between budgeted figures and actual income and expenses. Fundraising, grants, foundation and government support should be budgeted conservatively"(1991, p.83). An organization should look at timelines, restrictions for each contribution, and related expenses attendant to obtaining grants or other fundraising activities.

Example of Budget by Source ABC Projected Budget Revenues 2004

Estimated Revenues			**Annual Total**
Foundation Grants*			
	Oprah Winfrey Foundation	250,000	
	Ned Flanders Grant	500,000	
	Bourgeois International	100,000	
	Edwards Arts Focus	250,000	
TOTAL FOUNDATION			**1,100,000**
Government Grants**			
	NEA	50,000	
	NEH	25,000	

	ICA	2,700,000		
	ANYTOWN city govt.	1,300,000		
TOTAL GOVT GRANTS			**4,075,000**	
In-kind contributions		50,000		
TOTAL IN-KIND			**50,000**	
Fundraising Events				
	Be-Humble Auction	200,000		
	Dance the Night Fundraiser	300,000		
	Board Fundraising			
TOTAL FUNDRAISING			**500,000**	
Revenues				
	Admission	750,000		
	Classroom/workshops	100,000		
	Store sales	75,000		
TOTAL REVENUES			**175,000**	
Membership				
	Superfriend	5,000		
	Silver Member	3,750		
	Bronze Member	48,750		
	Gold Member	11,250		
	Platinum Member	50,000		
	Diamond Club	500,000		
	Everlasting Circle	500,000		
	Founder's Circle	500,000		
TOTAL MEMBERSHIP			**1,618,750**	
Interest Income		10,000		
TOTAL INCOME			**10,000**	
TOTAL EST. REVENUE				**8,278,750**

*These are grants the organization will receive in 2004
** NEA and NEH monies from a three-year grant; the organization has received notification that we will receive ICA and ANYTOWN grants in 2004.

An organization can estimate expenses by reviewing the planned activities for the upcoming year. After reviewing projected revenues, an organization should carefully review the support services needed to implement activities program by program. This estimate should include: number of individuals needed to carry out the program or activity; the space and facilities needed to complete the work; costs associated with transportation, mailings, advertising and other supplies. Finally, an organization can project how much and what kind of resources will be donated as in-kind contributions and other expenses that may be derived from the specific services offered by the nonprofit.

Example Projected Expenses by Program
ABC Projected Budget Expenses 2004

Budgeted Expenses			**Annual Total**
Program Services			
	Classroom/workshops	100,000	
	Teachers salary	200,000	
	Travel	10,000	
	Telephone	5,000	
	Supplies	300,000	
TOTAL PROGRAM			**615,000**
Support Services			
	Administrative salaries	1,000,000	
	Computers	200,000	
	Custodial services	100,000	
	Payroll fringe benefits	500,000	
	Travel	20,000	
	Legal	40,000	
	Telephone	20,000	
	Marketing	200,000	
	Occupancy	200,000	
	Misc. expenses	50,000	
TOTAL SUPPORT			**2,330,000**
Store Expenses			
	Merchandise	50,000	
	Inventory software	5,000	
	Misc. expenses	1,000	
TOTAL STORE			**56,000**
Fundraising			
	Special Events	250000	
	Printing	30,000	
	Postage	80,000	
TOTAL FUNDRAISING			**360,000**
Building			
	Structure	4,000,000	
	Furniture/display materials	500,000	
			4,500,000
TOTAL BUILDING			

Collections				
Care/Maintenance	100,000			
Purchases	50,000			
Collection/loan insurance	15,000			
Security	15,000			
TOTAL COLLECTIONS		**180,000**		
Total expenses before depreciation			**8,041,000**	
Depreciation		**89,000**		
TOTAL EXPENSES				**8,130,000**
Excess revenue over expenses				**148,750**
Excess expenses over revenue				**0**

The two previous budget examples provided in this paper have been based on funding streams (revenues) and separate program costs (expenses). These are two ways an organization can compile information for a budget. Other budgeting techniques are can include flexible budgeting, performance budgeting, cost benefit analysis, zero-based budgeting, and forecasting.

Flexible Budgeting

Flexible budgeting allows managers the ability to create operating budgets for various workload levels. Reviewing the volume of goods and services provided by the organization suggests the workload of an organization. “If the volume of services, cost of services, and revenues related to services all rose and fell in equal proportions, this might not create a significant problem” (Finkler, 2002, p.67). Generally, this does not happen within an organization and managers need to be able to predict what could happen if dramatic changes occur with services, expenses, and revenues. A flexible budget provides a manager the option to understand the impact of various workloads on an organization.

Example of a Flexible Budget:
Flexible Budget for ABC Nonprofit 2004

Volume of Participants per Program		**$ 35,000.00**	**$ 40,000.00**	**$ 45,000.00**
Revenues*				
	Donations	$100,000.00	$100,000.00	$ 100,000.00
	Fees	52,500	60,000	67,500
	Total Revenues	**$187,500.00**	**$200,000.00**	**$ 212,500.00**
Expenses				
	Salaries	$ 50,000.00	$ 50,000.00	$ 50,000.00
	Supplies	70,000	77,000	84,000
	Rent	12,000	12,000	12,000
	Other	5,000	5.000	5,000
	Total Expenses	**$137,000.00**	**$144,000.00**	**$ 151,000.00**
Surplus/(Deficit)		**50,500**	**56,000**	**661,500**

*For example purposes only, other revenues streams likely in similar situations.

Performance Based Budgeting

Performance based budgeting focuses on what the organization hopes to accomplish. (Finkler, 2001, p.68) An organization should use performance budgets in situations where there is an unclear relationship between outcome s and resources. Performance budgeting requires the organization to define clear goals and then dedicates resources to accomplish these goals. In addition, this method will allow the organization to assess how well it planned to utilize its resources for an intended goal.

Often performance budgets are centered around cost centers. A cost center for an organization can be a program or service provided by an organization. When an organization determines if it should use a performance budget the managers should determine the cost centers and the objectives that will accomplish the intended goals. After cost centers are established, managers must then consider if the objectives are appropriate for each cost center, what influence the objectives will have on an entire organization, and whether the cost center should be continued or discounted.

Example of a Performance Based Budget

Performance Based Budget					
Performance Area	**Type of Activity**	**Output Measure**	**Budgeted Output**	**Total Cost**	**Avg. Cost**
Improve Quality	Change in specific Performance	# of complications	10% reduction	$60,000	6000 per 1 % reduction
Perform Programs	education programs	number of programs	1000	$50,0000	$50/program
Improve Staff Satisfaction	Allow longer breaks and free coffee/donuts	Turnover rate	Reduce turnover by 50% from 6 years To 3 years	$20,000	$10000 /staff member retained

Cost-Benefit Analysis

Cost-benefit analysis compares the costs and benefits of organizations actions or programs. Usually required by the government agencies cost benefit analyses can also be used by small nonprofits for special occasions. For example, an organization may want to purchase a vehicle to service homebound individuals. It can institute a cost-benefit analysis of purchasing the vehicle by going through a five-step process: determine the project goals; determine the benefits of the purchase or program goals and determines project costs; determine the cost and benefit flow at an appropriate rate; and make a decision analysis based on the data collected. Organizations that utilize performance based budget or flexible budget along with a cost-benefit analysis can gather more information and, therefore, make a more informed decision. If the costs seem to high, or the costs increase dramatically over a long period of time, the organization should decide whether the project's intended benefits outweigh the high-cost of the project.

Zero-based Budgeting

Each item in an organization's budget is closely examined to determine its value. As Steven Finkler states, "Any items that do not add value or do not add sufficient value to justify their cost should be eliminated from the budget" (p.75). Zero-based budgeting is a time-consuming process and some organizations only use zero-based budgeting for new or existing programs, or use zero-based budgeting by rotating it into the organization budgeting schedule every three to five years.

Forecasting

When an organization plans a budget it must estimate what the revenues and expenses will be for a certain program and period of time. These predictions or forecasts can be made from historical data or, if none exists, from similar information garnered from comparable programs, organizations, or investigative cost-benefit analysis. In addition, an organization can form committees to research a program.

The basic premise on which to base budgeting revenues and expenses is a well-laid out plan for the next year. If an organization delivers multiple programs, the staff and board must determine the viability of each program and the revenues and costs associated with each. Variances between the actual and the projected budgets that appear throughout the year will be indicators of change within in the organization. If an organization completes next year's budget before the current year has ended, it can closely monitor the growth and decline of the organization's net assets.

Conclusion

As Stephen A. Finkler states, " A good place to commence financial statement analysis is by carefully and thoroughly reading the financial statements and the accompanying notes" (p.443). There are three predominant themes that should emerge during the review of statements. First, the organization should determine whether the financial management of the organization's finances is meeting the intended mission of the organization. Second, the analysis should determine the financial stability of the organization and compare this to overall trends in the nonprofit sector. Third, the financial statements should show results of the business activity by the organization. These results should be compared to the intended goals and objectives for the period and time and deemed acceptable or unacceptable.

Ideally, a yearly audit by a Certified Public Accountant (CPA) is performed to examine the financial statements and records of a nonprofit organization. After an audit is complete the CPA will attach an auditor's opinion letter indicating that the financial statements have been reviewed and that a certain level of compliance with GAAP principles has been achieved. An auditor can also aid an organization in reconciling its books but if severe financial errors are found the management team will be held accountable by federal and state regulations.

This paper has provided the basic framework of gathering together information for the balance sheet, operating statement and cash flow statement. It has also reviewed information on budgeting that will enable an organization to project what expenses and revenues may be incurred for a given period of time. Such information can form a more complete picture of the organization's financial position. Whatever the steps, a thorough preparation and review of financial statements is of vital importance to the nonprofit's continuing fiscal health.

Glossary of Terms

Accountant	A professional person who develops and maintains accounting systems interprets the data and prepares reports, supervises the work of accounting employees, and participates in management decisions.
Accounting	The process of gathering and preparing financial information about a business or other organization in a form that provides accurate and useful records and facilitates .
Accounting cycle	The total set of accounting procedures that must be carried out during each fiscal period.
Accounts payable	The money that a business owes to its trade creditors. This money is a liability of the business.
Accounts receivable	The money that is owed to a business by its customers. This money is considered an asset of the business.
Accrued expense	An expense incurred during an accounting period for which payment is not due until a later accounting period.
Accrual-basis Accounting	Under the accrual method of accounting, income is reported in the tax year earned, whether or not received, and deductions are claimed in the tax year incurred, whether or not paid.
Adjusting entry	An entry made before finalizing the books for the period to apportion amounts of revenue or expense to the proper accounting periods or operating divisions.

Asset Anything owned that has a dollar value.

Audit An examination of the accounting records and internal controls of a business in order to be able to express an opinion about the business's financial position and results of operation.

Balance Sheet A statement showing the financial position (the assets, liabilities, and capital) of an individual, company, or other organization on a certain date.

Bank reconciliation A routine procedure to find out the reasons for a discrepancy between the balance on deposit as shown by the bank and the balance on deposit as shown by the depositor.

Bookkeeper A professional who ensures that transactions are properly recorded and that supporting documents are present and correct. Carries out routine calculations, reconciliation's and bank transactions. Records daily business transactions in the accounting cycle.

Capital The difference between the total assets and total liabilities plus fund balances of a nonprofit.

Cash-basis Accounting Under the cash method of accounting, income is reported in the tax year actually or constructively received and expenses are deducted in the tax year paid.

Chart of accounts A list of the accounts of a business and their numbers, arranged according to their order in the ledger.

Cost of goods sold The total cost of goods sold during an accounting period.

Current assets Unrestricted cash, an asset that will be converted into cash within one year, or an asset that will be used up within one year.

Debtor Anyone who owes money to the business.

Depreciation The decrease in value of a fixed asset over time. For accounting purposes, this decrease is calculated according to a mathematical formula.

Dividend An amount of earnings declared by the board of directors for distribution to the shareholders of a corporation in proportion to their holdings, having regard for the respective rights of various classes of stock.

Drawings A decrease in owner's equity resulting from a personal withdrawal of funds or other assets by the owner.

Expense A decrease in equity resulting from the costs of the materials and services used to produce the revenue.

FASB 116 FASB statement No. 116 Accounting for Contributions Received and Contributions Made. Generally requires the recording of contributions and pledges received at their fair market value at the time of receipt.

FASB 117 FASB statement No. 117 Financial Statements of Not-For-Profit Organizations. Establishes standardized financial statements for most non-profit organizations and establishes the

requirements for the basic information that must be presented in order to be in conformity with generally accepted accounting principles. A new complete set of financial statements must include the following: a Statement of Financial Position (formerly Balance Sheet) reports assets, liabilities and net assets (formerly fund balance). The new reporting requirements require organizations to present net assets in three
Distinct classes: permanently restricted, temporarily restricted and unrestricted net assets.

Fiscal Period The period of time over which earnings are measured.

GAAP Generally accepted accounting principles.

General ledger A book or file containing all the accounts of the business other than those in the subsidiary ledgers. The general ledger accounts represent the complete financial position of the company.

Goodwill An intangible asset of a business that has a value in excess of the sum of its net sales.

Historical Cost An accounting principle requiring all financial statement items to be based on original cost.

Income An increase in equity resulting from the proceeds of the sale of goods or services.

Income Statement	Total incomes and total expenses incurred during a specific time period, or "fiscal period".
Journal	Diary of recording events of financial or operational in nature.
Ledger	A group or file of accounts that can be stored as pages in a book, as cards in a tray, as tape on a reel, or magnetically on disk.
Liability	A debt of an individual, business, or other organization.
Net worth	The difference between the total assets and total liabilities of a business.
Posting	The process of transferring the accounting entries from the journal to the ledger.
Prepaid expense	An expense, other than for inventory, with benefits that extend into the future, paid for in advance.
Retained Earnings	The capital that comes from company profits which has not yet been paid out to shareholders.
Revenue	An increase in equity resulting from the proceeds of the sale of goods and services.

Source document A business paper, such as an invoice, that is the original record of a transaction and that provides the information needed when accounting for the transaction.

Trial balance A special listing of all the account balances in a ledger, the purpose of which is to see if the dollar value of the accounts with debit balances is equal to the dollar value of the accounts with credit balances.

Working capital The difference between the current assets and the current liabilities of a business.

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