

Audit Opinion

What it is: These pages are the only ones that belong to the auditors. They indicate the opinion that is being issued on the financial statements based on the work performed.

What to look for: The opinion should say the financial statements are presented fairly in all material respects. In a standard opinion page, there will be a bold "Opinion" heading to direct your attention. Any exceptions or qualifications will also be clearly identified.

Statement of Financial Position (Balance Sheet)

What it is: This statement shows what the organization owns (assets), what it owes (liabilities) and what it is worth (net assets). Assets such as cash and investments are reported at their fair value while property and equipment are reported at their original cost and depreciated over the asset's life.

What to look for: You'll want to make sure the organization has a strong balance sheet with more assets than liabilities. Many nonprofits like to see reserves of 3 to 6 months (if not more). Reserves can be calculated using unrestricted cash plus receivables and investments (don't include endowment investments that can't be accessed) minus any accounts payable or accrued expenses that will need to be paid in the near term.

Statement of Activities (Income Statement)

What it is: This statement is also known as a Profit and Loss statement because it shows the organization's revenues and expenses for the year. The line "change in net assets" toward the bottom is the equivalent of net income in for-profit entities. For organizations that receive restricted donations, this statement often separates out restricted contributions and unrestricted contributions.

What to look for: A negative change in net assets is not a red flag by itself, but an organization doesn't want to operate like that for long or it will start to deplete its reserves. Be sure to pay attention to the sources of revenues to see how the organization is being supported; heavy reliance in one area, such as program income, contribution income, or investment income, could indicate risk to the organization.

Statement of Functional Expenses

What it is: This statement reports expenses by their natural category (salaries, rent, office supplies, etc) as well as by their functional category (Program, Management and General, and Fundraising). It can be very helpful to see where and how an organization is spending its money. This is usually a key statement for donors as they won't want to fund an organization that is all back office and no program work.

What to look for: The appropriate percent of program expenses can vary based on the type of organization. But before you strive for 100% program expenses, keep in mind that the organization has a fiduciary duty to monitor donor's funds and some overhead is necessary. In addition, spending some level of money on fundraising could pay dividends down the road.

Statement of Cash Flows

What it is: This statement is one of the most confusing for those not familiar with financial statements but it can tell the entire financial story of an organization. It begins with the change in net assets (ie. net income) for the year and proceeds to convert that accrual basis number to the actual change in cash from the beginning of the year compared to the end of the year.

What to look for: If you are still becoming familiar with financial statements, the easiest way to direct your attention on this statement is to focus on the big numbers. A big increase in receivables or a big equipment purchase could indicate why an organization is low on cash. A quick tip - a positive number indicates that area was a source of cash and a negative number indicates that area was a use of cash.

Notes to Financial Statements

What it is: The "Footnotes", as they are called, provide explanatory detail about the statements listed above. While they can be lengthy and detailed, key changes in the organization or other important factors should be further explained in the Footnotes.

What to look for: A quick comparison to last year's audit report will tell you whether there are any new footnotes that you should be concerned about. Other items to look for include: 1) *concentrations*, which may indicate reliance on only one or a few revenue sources; 2) *net asset and endowment notes*, which will identify donor restrictions at the end of the year as well as how restricted funds were used during the year; and 3) reference to *restatements*, which are changes in previously issued financial statements.