

The Balance Sheet: What it doesn't tell you that you should know!

The balance sheet is a critical component of the entire financial picture of any faith-based organization. Whoever makes up the finance committee, complete and accurate information is essential to good financial management.

The balance sheet is important to the organization's operations in general. It should provide a snapshot of what the organization owns and what they owe to outside sources. The balance sheet provides great insight into an organization's holdings.

To clarify, a balance sheet shows how much money the organization has, how much property they own, and most importantly, how much money they owe. This is beneficial for outside sources to view, such as bankers.

The balance sheet is broken down into several sections. Each section is grouped by liquidity – that is, how easily the particular asset can be converted into cash. The first section is short-term assets. Within this category, cash is listed first, followed by near cash assets. Near cash assets are assets that can be easily converted into cash. Accounts receivable, money that people owe the organization, is also listed in this category.

The next category is the long-term assets. These would include equipment, property, and buildings, along with long-term notes receivable. Generally, long-term assets are assets that cannot be easily converted to cash within a year's time.

After long-term assets comes the liabilities category. This category is also divided into short and long term – that is, short and long-term liabilities. In this case, time is generally defined in years – less than a year for short term, and more than a year for long term.

Short-term liabilities would include items such as mortgage payments for the next year, along with utilities and equipment leases. In addition, short-term liabilities include employee wages, usually listed as wages payable. Long-term liabilities would include items such as the remainder of the mortgage for future years, along with equipment leases. Items here overlap, as time is the separator, not the specific item.

Listed below are typical sections within a balance sheet that can be misleading or inaccurate.

1. **Assets.** Buildings or land should be listed on the balance sheet at cost. It's surprising how many times I see a balance sheet that doesn't list property. Even if the debt is paid, you should list the asset. It will remind

you of what should be insured and reflect the value of the property owned by the organization. Real estate is almost always the most significant asset and it should be on the balance sheet.

What really looks strange is a balance sheet that only lists the mortgage in long-term debt. The balance sheet ends up with a negative Fund Balance, which makes the organization look like it's spending more money than it is taking in.

2. **Restricted balances.** Typically, "restricted" is used to identify a donation that is to be used for a specific purpose. The donor may have specified that it be used only for debt pay-down, a certain mission or church program or so on. This restriction takes the money out of the available cash and restricts it to that particular use only. Only the donor can make the change from restricted to general.
3. **Restricted vs. budget reserves.** Organizations will decide to "restrict" funds for a particular use. Maybe it's to replace the HVAC or "rainy day" emergency fund. It may be described as restricted, but only for budget purposes has it been set aside. It's technically still part of the general fund. It's a budget reserve, not really a restricted reserve.
4. **Cash vs. accrual.** One of the most common difficulties emerging nonprofits face is the need to determine how to present its financial position. While accrual basis accounting is the best way to present your organization's financial position, most nonprofits start with cash basis accounting.

For accounting purposes, the best method is accrual-based. A cash-based system can distort the true financial condition of the organization.

- **Income:** The recognition of income for faith-based organizations is essentially the same. When you receive money, unless restricted, it's income. There are not receivables, per se. Members do make pledges or commitments, but that's not a receivable.
- **Expenses:** Under the cash method, an expense is recognized when it's paid. Under the accrual method, an expense is recognized when it is obligated to be paid. Under the accrual method, the expense goes against the appropriate expense category and is then added to accounts payable. When it is finally paid, it comes out of accounts payable.

Use of the accrual method clearly reflects the financial condition of the organization. All debts, both current and long-term, are on the balance sheet.

5. **Designated Funds.** These will be shown as part of the liability section. Here, the balances due to specific missions, projects or groups are detailed. The money may come through the general fund or may be restricted for a certain purpose. In this section, you should be able to see how much funds have been designated and for what. Money raised for specific purposes should be shown here. Unless restricted, they are all still part of the general fund and, as such, can be used for any purpose as determined by the organization.

An accurate balance sheet is a critical part of the financial reporting of any faith-based organization. It is an important guide in the decision making of the organization; it's important to outsiders who rely on its completeness and accuracy such as bankers, insurance underwriters, etc.

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