



A Crash Course in Reading **Nonprofit Financial Statements**

A Practical User's Guide with
Illustrations and Notes for Nonprofit
Founders, Directors & Board Members



THE
CHARITY
CFO

Why Do You Need To Read Financial Statements?

If you're in a leadership position for a nonprofit—directors, CEOs, managers, and board members—you must be able to read & understand basic financial statements.

Board members may have different titles—like Chairperson, Secretary, or Treasurer—but every single board member has a primary obligation to “fiduciary responsibility”.

In practice, many nonprofits lean on the members with a financial background to ask the tough financial questions...

But every board member has a responsibility to understand the organization's nonprofits. And to ensure that funds are being spent in accordance with both their mission and their donors' wishes. In fact, board members can be held personally liable for mismanagement of funds.

If you're the founder or the director of a nonprofit, your board will rightfully expect that you understand the financials too.

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Every board member has a “fiduciary responsibility” to understand the nonprofit's finances and act in the best interests of the organization.

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After all, how can you make day-to-day decisions if you don't understand how much money you have? Or what's coming in next month? Your board members & donors will challenge you on certain numbers, and you need to be prepared to explain the details and add context.

The good news? You don't need an accounting degree to understand nonprofit financial reports— they're actually pretty straightforward once you learn what to look for.

In this guide, we'll teach you to make sense of the two fundamental reports that every board member and director should review regularly.

By the end of this ebook, you'll be ready to confidently tackle conversations about your organization's finances!



A Note On Cash Vs Accrual Accounting



Vs



Financial reports can be prepared according to two different methods: cash basis or accrual basis. Fortunately, most modern accounting softwares can convert an accrual basis to a cash basis with the click of a button.

We encourage nonprofits to operate on an accrual basis accounting, as accrual reporting is required

by Generally Accepted Accounting Principles (GAAP), which is the authoritative source for accounting rules.

If you were to undergo an audit, this is what they would be looking for.

So better to start early and adopt this best practice now!



What Are Financial Statements?

Your financial statements are a summary of all the financial transactions of your organization during a specific period of time.

At a minimum, reports should be prepared on a quarterly basis and presented to the board during each board meeting. In many cases, some members of the board (typically the Finance Committee) will get these reports on a monthly basis.

Some reports cover transactions in a specific time period (i.e. everything that occurred within a given month or quarter) and others reflect an accumulation of activity that happened over the life of the organization. It's important to see both formats to ensure you understand both the short-term results and long-term trends within your business.



For - Profit Vs. Nonprofit Financial Reports



Vs



The nonprofit accounting world uses different terminology than what you may have heard in the for-profit world. The main reason for the difference is that nonprofits don't have ownership or equity within their structure, so the concept of "equity" and even "income" are viewed differently.

Here are the key differences you'll need to know:

For-Profit Terminology

- Balance Sheet
- Income Statement
(or Profit & Loss Statement)
- Equity
- Income

Nonprofit Terminology

- Statement of Financial Position
- Statement of Activities
- Net Assets
- Change in Net Assets

What is the Balance Sheet?

The balance sheet is called the Statement of Financial Position in the nonprofit world, but we find that many organizations refer to it as the “Balance Sheet” when discussing it internally. That is completely fine, just be aware that your auditors or other outside stakeholders will often use the technical name.

The Balance Sheet (Statement of Financial Position) gives you a snapshot of 3 critical elements at a specific moment in time:

1. Your **Assets**, or everything your company owns or is entitled to
2. Your **Liabilities**, or everything your organization owes to others
3. Your **Net Assets**, or everything that is left over if you subtract your liabilities from your assets. It’s the value of your organization, or “equity” in the for-profit world.

It’s important to note that the Balance Sheet reflects a specific moment in time and can change greatly over time, even day-by-day. That’s why it’s important to compare your current Balance Sheet to the most recent ones, to note how certain balances grow, or shrink, over time.

The biggest benefit of the Balance Sheet is that the balances are an accumulation of the activities that have happened since the inception of the organization. So it shows if your organization accumulated a surplus or deficit over time.

As such, it’s key to helping you understand sustainability and long-term financial management.

What Are “Restricted Assets”?



As a nonprofit, you’re required to track restrictions placed on your assets by donors—like if a donation or grant can only be used on a specific program, for example. You have to track all restrictions on gifts you receive (i.e. timing restrictions, program restrictions, permanent/endowment restrictions, etc.) and track how you use that money and the remaining balance, which you’ll show on the Balance Sheet as “Net Assets with Donor Restrictions.”



What is the Income Statement?

The Income Statement (the Statement of Activities) summarizes all revenue you've generated and expenses you've incurred over a specific period of time.

Where the Balance Sheet shows what you owe and own at a single point in time, the Income Statement reports activity, revenues and expenses, over a designated period of time. That time period could be a month, a quarter, this year-to-date, or even an entire previous year.

The Income Statement makes it easy to see how well your organization raised funds, and how it spent those funds, during the reporting period. It shows you how much money you've brought in, from what sources, and any donor-imposed restrictions that exist for those that money.

It also tells you how much you have spent by general categories, so that you can identify the expenses that go beyond what you had planned.

The main sections you'll see on the Income Statement are:

- **Revenue** is all cash or other assets earned, pledged, or given to your organization. Revenue will generally be broken into 3 main categories:
 - **Public Support** - Funds received with no financial exchange, such as individual donations, grants, etc.
 - **In-Kind Revenue** - Donation of assets other than cash or cash equivalents, such as donated supplies, services, artwork, inventory, office space or etc.
 - **Earned Income** - Any revenue earned through the delivery of services or sales of goods to the community, such as thrift store sales, program fees, memberships, etc.)
- **Expenses** are funds or assets spent on cash spent on organization's activities (i.e. payroll, utilities, rent, etc.).
- **Change in Net Assets** is the difference between your revenue and expenses within the given time period. For-profit businesses refer to this as Net Income, or simply "profit."



A Primer On Functional Expenses

Nonprofits must categorize their expenses by both their natural classification (the category of expense, like payroll, utilities, or rent) as well as the function that expense served within the organization.

There are three recognized functional categories:

General and Administrative - this function can sometimes be called other things (Management and General, Administrative, etc.). The costs associated with this function included expenses used for general oversight and management. Examples include: accounting, legal, IT, payroll, etc.

Fundraising - this function includes all activities related to generating contributions, grants, and other public support. Activities could include: grant writing, fundraising events, marketing and annual reports, etc.

Program - this function includes the activities associated with fulfilling the organization's mission. Expenses would include direct program supplies, program staff and benefits, etc.

Many expenses should be allocated between functions. Design an allocation plan to ensure that you are allocating costs appropriately. Nonprofits typically strive for 65-75% or more of their expenses to go to programming.



Using Your Financial Statements

The Balance Sheet and Income statement will help you answer the big questions about your finances in a glance, like:

1 Did we earn more than we spent?

If your Change in Net Assets on the Income Statement is positive, then you did! (And if you didn't, that could be okay too. Not every period will see an increase. But you do want to see more increases than decreases, over time.)

2 Do we own more assets than we owe to others?

If your Net Assets balance is positive on the Balance Sheet, then you do have more assets than liabilities. Which is good. But for a nonprofit it can be more complicated.

3 Can we spend the money we have?

For this one, you'll want to look at the "Unrestricted Net Assets" line of your Balance Sheet. Because many donor-restricted funds or endowments can't actually be used to pay many of your expenses or debts.

Useful Financial Ratios:

And beyond those “big questions,” you can use these 2 statements to quickly calculate some ratios that donors, banks, grant makers and watchdog agencies (like the Better Business Bureau) may use to analyze the health of your business.

Operating Reserve Ratio

An operating reserve is a balance of cash (and/or short term assets that can be quickly converted to cash) that you can use to maintain operations in case of a short-term lack of funding. It's generally equal to your Total Unrestricted Net Assets on your Balance Sheet.

The United Way and others recommend that you have an Operating Reserve equal to 25%-75% of your annual expenses. Here's how to calculate your OR percentage:

Total Net Assets without Donor Restrictions	1,000,000
Less: Total fixed assets	(25,000)
Total Available Net Assets without Donor Restrictions	975,000
Total Annual Budget	2,500,000
Operating Reserve %	39%

Days in Cash

While funders may want to see your Operating Reserve Ratio, a more useful metric to the management of a nonprofit is the Days in Cash. Simply, this is how long you can continue to operate with the cash you have on hand.

You can calculate it with this formula:

$$\frac{\text{Total Cash \& Cash Equivalents}}{[(\text{Annual Operating Expenses} - \text{Depreciation}) \div 365]}$$

You should always strive to have a minimum of 30 days of cash on hand at your lowest balance. Every organization has monthly and annual cycles of cash. Keeping an eye on Watching this number will help you understand your monthly and annual cycles of cash to better manage your operation.

More Useful Financial Ratios



Unrestricted Net Assets/ Accumulating Funds

Funders don't want to feel like you'll sit on their cash instead of putting it to work. For that reason, your unrestricted net assets should not exceed three times your past year's expenses or current year's budget (whichever is higher).

Fundraising Efficiency

Your fundraising expenses (as shown on the Statement of Functional Expenses) should not exceed more than 35% of related contributions or you'll raise unwanted red flags with certain donors and organizations.

Program Expense Ratio

Most external organizations want to see at least 65% of your total expenses go toward running and supporting programs, as reported on the Statement of Functional Expenses.

Sample Balance Sheet & Income Statement

The easiest and best way to get familiar with these statements is to jump right in and look at them.

We've prepared this Balance Sheet and Income Statement for a fictional nonprofit and filled them with notes, highlights, and tips to help you make sense of them. Every organization is unique, so your financial reports may have some categories or items you don't see here. But the main sections and overall layout will be very similar



Sample Nonprofit
Statements of Financial Position (Balance Sheet)
As of December 31, 2025 and 2024

ASSETS	2025	2024
Current Assets		
Cash	185,726	357,825
Investments - Current	78,514	54,824
Total Cash and Cash Equivalents	264,240	412,649
Accounts Receivable	248,752	354,781
Allowance for Doubtful Accounts	(25,675)	(24,581)
Net Accounts Receivable	223,077	330,200
Pledges Receivable	250,000	175,000
Allowance for Doubtful Accounts	0	(15,000)
Net Pledges Receivable	250,000	160,000
Inventory	15,784	12,581
Prepaid Expenses	1,578	2,548
Total Other Current Assets	17,362	15,129
Total Current Assets	754,679	917,978
Endowment	125,481	113,548
Property and Equipment		
Land and Land Improvements	25,000	25,000
Buildings	325,000	325,000
Leasehold Improvements	15,487	15,487
Furniture and Equipment	25,481	17,488
Total Property and Equipment	390,968	382,975
Accumulated Depreciation	(48,571)	(36,847)
Net Property and Equipment	342,397	346,128
Total Assets	1,222,557	1,377,654

Do you understand what is causing your cash to go up or down from year to year?

Accounts Receivable are typically associated with program fees or earned revenue. This is different than a pledge receivable.

Understand the nature of an endowment and when or if it can ever be used in operations. Also understand your investment policy to ensure that you aren't overly risky in your investments.

Pledge receivable are unconditional promises to give without an exchange of goods or services. It does not generally include program fees or earned revenue.

The change in accumulated depreciation year over year represents the annual depreciation expense.

Every nonprofit should try to keep debt to a minimum. Pay attention to the cash needs to repay this debt and take it into consideration when you plan your budget.

Pay attention to increasing accounts payable. Are your balances growing? If so, this might be an indication that you're falling behind on our vendor payments (and cash flow may be tighter than it appears!)

LIABILITIES	2025	2024
Current Liabilities		
Accounts Payable	15,784	13,524
Line of Credit	12,500	25,000
Total Current Liabilities	28,284	38,524
Long-term Debt	250,000	275,000
Total Liabilities	278,284	313,524

NET ASSETS	2025	2024
Net Assets without Donor Restriction	1,357,842	1,125,478
Board Designated Assets	25,000	15,000
Total Net Assets without Donor Restrictions	1,382,842	1,140,478
Net Assets with Donor Restrictions	117,999	550,700
Total Net Assets	1,500,841	1,691,178

Review Net Assets with Donor Restrictions and compare to the cash and investments in your bank account. Are you upside down here? In other words, have you spent cash received with restrictions on operations?

Watch donation trends closely! Why are they going up or down? Is it a temporary problem of timing? Or are you losing public support?

Program fees are earned income and different than public support-- like when a childcare facility charges a tuition to parents

Often nonprofits don't budget investment income, but it can significantly impact financial reports (especially if you have a large endowment)

Understand the trends of your program services. We want program expenses divided by total expenses to be at least 65%. If there are large swings, we need to understand why.

M&G + Fundraising expenses should be 35% or less of total expenses. If there are changes year over year or your ratios are not in line with these benchmarks, understand why.

Pay attention to trends in net income. Are we consistently having net incomes or losses? It's ok to lose money in a year. It is not ok to consistently lose money. We will eventually run out of assets and the organization will be forced to borrow in order to survive or shut down..

This line represents "net income" in the nonprofit world. The total column represents the total net income or loss for the year.

Sample Nonprofit Statements of Activities (Income Statement) As of December 31, 2025 and 2024

	Without Donor Restrictions	With Donor Restrictions	Total 2025	Total 2024
Income				
Individual	15,748	0	15,748	21,515
Foundations	1,548	152,254	153,802	165,481
Government	155,481	25,000	180,481	74,518
Program Fees	123,558	0	123,558	120,365
Special Events, Net	154,893	0	154,893	141,895
Investment Income	12,548	0	12,548	156,123
Net Assets Released from Restrictions	48,157	(48,157)	0	0
Total Income	511,933	129,097	641,030	679,897
Expenses				
Program Services	487,512	0	487,512	354,871
Management and General	74,581	0	74,581	65,815
Fundraising	25,111	0	25,111	142,358
Total Expenses	587,204	0	587,204	563,044
Change in Net Asset	(75,271)	129,097	53,826	116,853
Net Assets, Beginning of Period	1,548,752	254,815	1,803,567	1,686,714
Net Assets, End of Period	1,473,481	383,912	1,857,393	1,803,567

Government contracts require specific compliance. As this figure grows, understand what additional compliance needs we are subject to, like audits or periodic reporting. (Noncompliance can lead to loss of funding)

Special event income is oftentimes shown as "net of expenses," meaning after subtracting costs that benefited attendees (i.e. food, drinks, entertainment, etc.).

This line represents the amount of restricted assets pledged or collected last year but released in the current year. In other words, the revenue was recorded last year but not spent until this year. As such, the net amount on this line item is always zero - showing additional revenue in the current year would essentially be double counting and not allowed. This is oftentimes a source of confusion for most readers of nonprofit financials.

Fundraising expenses should be 30% of fundraising revenue (public support including individuals, foundations, government (in most cases) and special events). If your ratios are higher, understand why.

This line represents the amount of net assets since inception. It is important to have a positive number here. Having a negative number suggests that we have been financing our operations through short or long term loans - which is not sustainable. The larger the net assets without donor restrictions, the better.

About The Charity CFO



Tosha Anderson, CPA, MBA
Founder & CEO

The Charity CFO provides outsourced bookkeeping and accounting services to 150+ nonprofits across the USA.

We work exclusively with nonprofit clients and have former nonprofit auditors and multiple former nonprofit CFOs on our team. So we understand the exact challenges your organization faces on a daily basis. And we know exactly what your board members, donors, grant makers, and auditors want to see when they look at your books.

From optimizing and modernizing your accounting system to providing you with clean and accurate financial reports every month, The Charity CFO can make your life so much easier.

And our team of nonprofit finance experts is always at your service to help you find a path through your latest crisis, plan your annual budget, or set the groundwork for an ambitious expansion plan.

When you're ready to stop relying on an all-purpose CPA that doesn't understand your business or your mission, reach out to us to see how we can make your financial life easier.



Tim Hudson, CPA, MA
Partner & COO



Simplify your accounting with
The Charity CFO

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Come Work With Us!



“Even better than I expected!

Their quickness to understand our finances blew me away. The reports we get each month em-power our team leaders to take ownership of their departments. Which, in turn, empowers me to lead the school according to my vision.”

DEB KRAUSE
CEO
EDEN THEOLOGICAL SEMINARY



“The Charity CFO has my back!

Before The Charity CFO, our reports changed every year. Now we have consistency and accuracy. Everything is documented. It's too easy to keep doing the same thing even when it's not really working. I'm glad we made the change.”

MARK WITZLING
EXECUTIVE DIRECTOR
CRAFT ALLIANCE

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