The Nonprofit Board Member's Go-To GLOSSARY of Financial Terms

A

Accounts payable: The amount of money known to be owed (i.e., unpaid invoices that have been recorded) to vendors and suppliers that have provided goods or services to an organization.

Accounts receivable: Money owed to a nonprofit for services rendered or goods provided on credit.

Accrual accounting: Accounting method that recognizes transactions when they occur, rather than when cash is received or paid. (Contrast with Cash-basis accounting.)

Accrued liabilities: The amount estimated to be owed (i.e., invoices that have not yet been received and recorded) to vendors or suppliers that have provided goods or services to the organization.

Amortization: The process of allocating the original cost or fair value of a long-lived intangible asset over its estimated useful life. (See Depreciation.) Conceptually, depreciation and amortization are the same thing. In practice, depreciation is most often used with tangible assets, and amortization with intangible assets and liabilities.

Annuity gift (gift annuity): A contribution given on the condition that the recipient organization make periodic stipulated payments to the donor or other designated individual. After termination of the stipulated payments, the organization keeps the remaining principal of the gift.

Asset: Something of value owned or controlled by a person or organization.

Audit: The procedures performed by an independent certified public accountant (CPA) to be able to give an opinion that an organization's financial statements are fairly stated in all material (significant) respects.

Audit committee: A committee of the board whose primary function is to accept and review reports provided by external auditors and to select the firm that will provide the next year's audit.

Auditor: The Certified Public Accountant (CPA) who conducts an independent audit for a nonprofit.

Average payment period ratio: Measures the average time that elapses before an organization's current liabilities are paid.

B

Bad debts: Accounts receivable that are deemed uncollectible or of doubtful collection.

Bad-debt expense: A statement of activities account that includes credit sales that are written off as uncollectible.

Balance sheet: See Statement of Financial Activities.

Balanced scorecard: An integrated set of measurements assisting an organization in keeping track of its outcomes as compared to its goals. It utilizes four performance measures: financial perspective, customer perspective, internal perspective, and learning and growth: to help monitor and improve an organization's level of effectiveness.

Benchmarking: Compares ratios, trends, and analyses (both financial and nonfinancial) of a nonprofit with those of its peers, and measures an organization's results against its best-performing peers.

Bond: A certificate of debt issued by a government or corporation to raise money for an organization.

Bonding: A type of insurance recommended to have in place covering all volunteers and employees who have access to the organization's cash or other valuable assets. If a covered individual misuses funds, the organization will recover its loss from the bonding company (up to the amount of the bond).

Budget: A detailed annual financial plan that anticipates and projects both revenues and expenses of an organization.

GLOSSARY
of Financial Terms

C

Capital expenditures: Funds that are used to acquire long-term assets, such as buildings, land, equipment, etc.

Capitalization: Converting an expense into an asset; it spreads the cost of an asset over the length of time of its usefulness. **Capitalization of a fixed asset** converts an expenditure into a fixed asset, based on the dollar value and useful life of the asset.

Cash: Assets in the form of currency, or cash equivalents that can be easily and quickly converted into currency.

Cash-basis accounting: Accounting method that recognizes transactions only when cash is received or disbursed. (Contrast with Accrual accounting.)

Cash/current: Generally includes cash in bank accounts, **cash equivalents** (anything easily convertible to cash within one day, such as money market accounts), and certificates of deposit (if less than 365 days to maturity).

Cash flow: The process in which cash is received and disbursed by an organization. Many nonprofits have a cyclical cash flow with a larger influx of cash based on year-end contributions or prior to the annual meeting, and significantly lower receipts at other times of the year. As a result, good managers of financially weaker nonprofits will be quite familiar with the cash flow pattern of their organization and plan expenditures accordingly.

Cash/noncurrent —Generally includes cash designated for capital replacement and acquisition that is invested in longer-term assets (such as Treasury bills or bonds) and trustees' investments (cash set aside from bond proceeds to be used in capital projects), with maturity expected to exceed 365 days.

Conditional promise to give: A promise to give that depends on the occurrence of a specified future and uncertain [qui vide] event to bind the promisor. (See Donor-imposed condition.)

Conflict-of-interest policy: A written document intended to ensure that decisions made about an organization's operations and the use of its assets are made solely with the best interest of the organization in mind, and that no private or personal benefit to any affiliated individual will result. All board members and key employees should be cognizant of the conflict-of-interest policy, and annually disclose whether they have any "interests that could give rise to conflicts" (IRS Form 990).

Consolidated financial statements: Financial statements that include added-together financial information for two or more related entities.

Contribution: An unconditional transfer of cash or other assets to a qualified tax-exempt organization (or a settlement or cancellation of its liabilities) in a voluntary nonreciprocal transfer by another person or entity. (Contrast with Exchange transaction.) Contributions include gifts of money, property, the use of property, and services of volunteers; unconditional promises to make gifts in the future; and bequests.

Current ratio: Measures an organization's liquidity, or how readily the organization is able to pay off all its current liabilities.

Custodian fund: Funds received and held by an organization as a fiscal agent for others.

D

Dashboard report: A report that communicates critical information in a concise, visual, more compelling way than traditional narratives or financial statements. This type of reporting allows leaders and managers to focus on key trends and relationships that are fundamental to the success of the organization.

Days cash on hand ratio: Measures the number of days of average cash expenses that an organization maintains. The ratio can be expressed in terms of either days cash on hand in short-term sources or in all sources.

Days in accounts receivable ratio: Measures the average time that accounts receivable are outstanding (also known as the average collection period).

Debt service coverage ratio: Measures the ability of an organization to pay back its long-term debt by comparing its bottom line cash with its annual debt service payments (principal + interest expense).

Deferred gift: A gift whose benefit to the nonprofit recipient is delayed until a later time. (See Split-interest gift.)

Deferred revenue: Revenue received in one accounting period that, because it has not yet been earned (by the provision of goods or services to the payor), is recognized in a later accounting period when the goods or services are furnished. Example: A theater subscriber pays for season tickets in June for the season starting the following September. As of June 30, the theater records the revenue as deferred until the season when the plays will be performed opens.

Depreciation: The process of allocating the original cost of a long-lived tangible asset over its estimated useful life. (See Amortization.) Conceptually, depreciation and amortization are the same thing. In practice, depreciation is most often used with tangible assets, and amortization with intangible assets and liabilities.

Depreciation expense: An expense on the statement of activities arrived at by allocating (amortizing) a defined part of a long-term asset over its estimated useful life.

Designated fund(s): Refers to unrestricted resources that the board has voted to set aside for a period of time or for a specific use. While the board may use the term "endowment fund," because the restriction was set internally, the funds can be made available by the board for any use at any time. Hence, board-designated funds are correctly classed with unrestricted net assets.

Directors' and Officers' Insurance: A policy that protects the board and officers if they are acting responsibly by covering a variety of potential vulnerabilities, including libel and slander, acts beyond granted authority, wrongful termination and/or discrimination, inefficient administration or waste of assets, and the like.

Disclaimed opinion letter: See Opinion letter.

Donor-imposed condition: A donor stipulation that specifies a future and uncertain event whose failure to occur releases the promisor from the obligation to transfer assets (or gives the promisor a right of return of any assets it has already transferred).

Donor-imposed restriction (related to temporary restriction): A donor stipulation that specifies a use for a contributed asset that is more specific than broad. A restriction on an organization's use of the asset contributed may be temporary or permanent.

Donor-restricted endowment fund: An endowment fund created by a donor stipulation that requires investment of the gift in perpetuity or for a specified term. (See Endowment fund.)

E

Efficiency ratio: Measures the proportion that a nonprofit is spending on programs to achieve its mission by comparing spending on management and general plus fundraising to its spending on programs.

Endowment fund: An established fund of cash, securities, or other assets to provide income for a nonprofit organization. The use of the assets of the fund may be permanently restricted, temporarily restricted, or unrestricted. Restricted endowment funds are established by donor-restricted gifts and bequests to provide a permanent endowment (a permanent source of income) or a term endowment (income for a specified period).

Exchange transaction: A revenue transaction related to the provision by an organization of goods or services to customers in exchange for payment of approximately commensurate value. (Contrast with Contribution.)

Expenses: What an organization spends to conduct its activities (for example, salary, office supplies, rent).

F

Fair value: The amount at which an asset could be bought or sold in a current transaction between willing parties: that is, other than in a forced or liquidation sale; usually equivalent to market value.

FASB (Financial Accounting Standards Board): The private sector body primarily responsible for setting generally accepted accounting principles (GAAP) for all nonprofit and for-profit entities other than governments.

Fixed assets: Tangible property with a long-term useful life, such as land, land improvements, buildings, building equipment, movable equipment, furniture, leasehold improvements, or capitalized leases.

Footnotes/Notes to financial statements: Addenda to the financial statements. Some are required by GAAP, such as the first footnote on all financial statements, which is a summary of significant accounting policies used in the creation of a nonprofit's accounting books and records. Additional notes may be used to describe the nonprofit's programs, investments and investment policies, affiliated organization investments, property and equipment, lease commitments, contingent liabilities, long-term debts and leases, joint cost allocations, related party transactions, pension plans, temporarily and permanently restricted assets, and any significant subsequent events.

Form 990: The Internal Revenue Service (IRS) form used to report annually to the IRS (and to many states) on the financial and other activities of a tax-exempt organization.

Functional expenses: A method of grouping expenses according to the purpose for which costs are incurred. The primary functional classifications are program expenses, fundraising expenses, management, and general expenses. (Contrast with Natural expenses.)

Fund: An accounting entity established to track the resources of a specified subpart of an organization, such as a project, donor-restricted gift, board-designated pool of assets, activities in a certain geographic area, fixed assets, or other defined unit.

Fund balance: The excess of assets over liabilities of a particular fund of an organization. (See Net assets.)

Fundraising expenses: Expenses incurred to induce donors, foundations, and others to make contributions to an organization.

Fundraising ratio: Measures the efficiency of a nonprofit's fundraising programs by comparing the amount spent on fundraising to how much it receives in contribution and grant revenue.

G

GAAP (Generally Accepted Accounting Principles): The rules for recording and reporting transactions in financial statements. In the United States, these are promulgated primarily by the Financial Accounting Standards Board and secondarily by the American Institute of Certified Public Accountants (AICPA).

GAAS (Generally Accepted Auditing Standards): The procedures undertaken by an independent certified public accountant to issue an opinion on the fairness of the presentation of financial statements. In the United States, these standards are promulgated by the AICPA.

Gift-in-kind: A contribution other than cash or marketable securities. Includes property, supplies, equipment, use of property (free rent), and qualified donated services of volunteers.

Grant: Properly used to refer to an award by a foundation, company, nonprofit organization, or government agency to an organization or individual. The word does not have a precise meaning in accounting and is often used interchangeably with contribution; however, not all grants are contributions: some are exchange transactions.

I

Income Statement: See Statement of Activities.

In-kind donation: See Gift-in-kind.

Interest expense ratio: Measures the overall average percentage interest rate being paid by the organization to finance its debt.

Interest income ratio: Measures the overall average percentage earnings on all of the organization's assets that have the potential to be invested.

Internal controls: Those processes and procedures that protect the assets of an organization and promote its efficient operation thus helping to ensure its long-term stability and continuation of programs. Good controls act as both a deterrent to, and detective of, improper behavior by staff and volunteers. The key to good internal controls is segregation of duties. The general rule is that no one person should be in a position to completely control all aspects of a transaction from its initiation through approval, handling of assets, and recording.

Intermediate sanctions: Penalties that may be imposed by the IRS when it finds any evidence of inappropriate personal gain (termed private inurement) in a nonprofit that it is auditing. In these cases, not only must the recipient return the excessive financial benefit and pay penalties, but the IRS may impose financial penalties on board members and managers who knowingly approved the transaction or contract.

Investment committee: Drafts and oversees the organization's investment policies, including liaison with outside investment advisors. Because this committee monitors investment performance, it needs members who are familiar with investing. In most cases, the committee does not become involved in the details of individual investment purchase and sale decisions but hires outside advisors to do so. The committee should monitor the activities of the outside advisor to ensure that the organization's investment policies are being adhered to.

Investment policy: A board-approved document that delineates a specific philosophy of investment management and establishes parameters for investment risk and return. Some policies, especially those for organizations with smaller reserves, indicate which specific investments are allowed. For example, a very conservative investment policy might allow only FDIC-insured bank accounts with balances under the $100,000 limit and short-term U.S. Treasuries. The policy should assist and protect designated investment managers by setting up practical guidelines and clear performance objectives. It should also establish a process for regularly reviewing investment objectives and strategies and reviewing the manager's performance.

J

Joint costs of multipurpose activities: Costs incurred in an activity that includes at least two different types of functional expenses (most often, program and fundraising components). Organizations mailing requests for contributions that also educate potential donors must take exceeding care in appropriately splitting the costs of such mailings between the two functions.

L

Liabilities: Everything an organization owes, the sum of its debts and obligations. **Current liabilities** are those that are due to be paid within 365 days; **long-term liabilities** have a due date beyond 365 days.

M

Management and general expense: Expense other than program, fundraising, or membership development. Includes expenses for oversight, business management, general record keeping, budgeting, financing, and related administrative activities.

Management letter: Sometimes called an internal control letter. A communication from the organization's auditor that the board should always receive following an external audit, it provides the auditor's observations on any control deficiencies, significant deficiencies, or material weaknesses discovered in the internal control structure of the organization during the audit. Significant deficiencies represent serious matters, and material weaknesses are very serious matters. Both require the board's immediate attention, followed promptly by corrective action.

Membership development expense: Expenses incurred to induce new members to join a membership organization.

Member's audit: A process used to provide limited assurance to the membership in which two or more financially astute volunteers visit the organization and test some of its fiscal activities and records, such as cash disbursements, cash receipts, whether key assets actually exist, and whether the payroll records are in good order. As with an external audit, no area of activity can be sacrosanct for a members' audit. The volunteers undertaking this effort must feel free to look where they please and be creative in their investigations. Some organizations that use member audits have an external auditor accompany the volunteers to aid or guide their efforts.

N

Natural expenses: Classification of expenses by categories such as personnel costs, occupancy, travel, supplies, and professional fees. (Contrast with Functional expenses.)

Net assets: The excess of assets over liabilities of a fund or an entire organization. Net assets may be categorized as unrestricted, temporarily restricted, or permanently restricted. (See Donor-imposed restriction.) Net assets are sometimes referred to as net margin.

Net (or total) margin ratio: Measures profitability based on all revenues, including non-operating revenues. This typically means investment income is included, although it is generally classified as non-operating.

Nonprofit Audit Guide: Periodically updated collection of generally accepted accounting principles (GAAP) and other authoritative guidance, as they apply to nonprofit organizations' accounting. Issued by the AICPA.

Not-for-profit/Nonprofit organization: An entity that possesses the following characteristics that distinguish it from a business enterprise: (a) contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return, (b) operating purposes other than to provide goods or services at a profit, and (c) absence of ownership interests like those of business enterprises. Nonprofit organizations have those characteristics in varying degrees. Organizations that clearly fall outside this definition include all investor-owned enterprises and entities that provide dividends, lower costs, or other economic benefits to their owners, members, or participants, such as mutual insurance companies, credit unions, cooperatives, and employee benefit plans. (See Tax-exempt.)

Nonreciprocal transfer: A transaction in which an entity incurs a liability or transfers an asset to another entity (or receives an asset or cancellation of a liability) without directly receiving (or giving) value in exchange. (See Contribution.)

O

OMB Circular A-133: Publication of the U.S. Office of Management and Budget, which requires that organizations spending $500,000 or more of federal grants and contracts in a year have a special audit of those federal funds. (The OMB recently increased the spending amount to $750,000, to be phased in based on the ending date of the fiscal year. See the Circular or contact your auditing firm for precise definitions.)

Operating margin: The excess or deficit of revenues over expenses.

Operating margin ratio: Measures profitability by comparing an organization's bottom line (the excess of support and revenues over expenses) to its total revenues.

Operational reserves: See Reserves.

Opinion letter: Produced by an organization's external auditors at the conclusion of their review of the year-end figures, the opinion letter expresses judgment on whether the management-prepared financial statements are "presented fairly" in accordance with GAAP and accurately reflect the financial status of the nonprofit. A clean opinion letter indicates full compliance with generally accepted accounting practices (GAAP). A qualified or adverse opinion letter is a judgment by the external auditor that he or she believes that an organization's financial statements are not incompliance with GAAP. A disclaimed opinion letter is a judgement by the external auditor that he or she is unable to form an opinion on a nonprofit's financial statements due to incomplete information provided by management.

P

Permanent restriction: A donor-imposed restriction stipulating that resources be maintained permanently but permitting the organization to use or expend part or all of the income (or other economic benefits) derived from the donated assets.

Permanently restricted net assets: The part of the net assets of a nonprofit organization resulting from contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of the organization.

Plant fund: An accounting unit (see Fund) used by some organizations to record transactions related to land, buildings, vehicles, and equipment.

Plant ledger: A subsidiary ledger of the general ledger, where all the elements for each individual asset, such as the asset's description, original cost, date of acquisition, annual depreciation expense, and accumulated depreciation.

Pledge: A written or oral agreement by a donor to make a contribution to a nonprofit organization. A promise to pay.

Prepaid expense: An expense paid in one accounting period, where the benefit of the expense is not yet received by the organization paying it, and recognition is delayed until a future accounting period after the benefit of the expense is received. Example: A rent payment for January is made before the end of the preceding December and thus is correctly classified as a prepaid rent.

Private inurement: Improper receipt of a financial benefit by a person who is an "insider" to a nonprofit organization. Insiders include members of the governing board and senior management, close members of their families, and other organizations with which they are connected. Illegal under Section 501(c) of the Internal Revenue Code, private inurement can lead to financial penalties against both the receiver of the benefit and the persons in the organization who authorized the benefit, along with possible loss of tax-exempt status.

Program expense: An expense that directly or indirectly supports specific activities constituting an organization's purpose(s) or mission(s) for which it exists. (See Supporting expense.)

Promise to give: A written or oral agreement to contribute cash or other assets to an entity. A promise to give may be either conditional or unconditional. The word pledge is often used interchangeably.

Q

Qualified or adverse opinion letter: See Opinion letter.

Quasi-endowment fund: Unrestricted endowment. (See Endowment fund.)

Quick ratio: Measures the organization's ability to meet short-term obligations from its most liquid, or quick, assets. It compares assets that are quickly and easily convertible into cash (such as cash, cash equivalents, and accounts receivable) to the organization's current liabilities. (Also known as asset ratio.)

R

Ratio analysis: A method for taking two or more informational elements and utilizing them together to obtain additional information. Financial ratio shows relationships between raw data in the financial statements, usually expressed as percentages.

Reclassification: The movement of resources between classes of net assets. The most frequent reclassification is movement from temporarily restricted net assets to unrestricted net assets upon the fulfillment or expiration of a donor-imposed temporary restriction.

Reserves: Not a precisely defined term, but often used to refer to the amount of resources currently available to an organization to use in any way it chooses (presumed to be limited to activities consistent with its mission.) Many in the nonprofit industry define reserves as being the equivalent of net assets (i.e., assets minus liabilities). This, however, fails to take into account the fact that reserves should be available to be spent in a time of need. Thus the figure should not include illiquid assets such as land and buildings, nor be reduced for such long-term debts as mortgages. In precise accounting terms, reserves might be more accurately defined as the unrestricted net asset balance less equity in property and equipment, plus the expendable temporarily restricted net asset balance, plus the deferred revenue that will become available within one year.

Restricted assets: See Net assets.

Restricted support: Donor-restricted revenues from contributions that increase either temporarily restricted net assets or permanently restricted net assets. (See Unrestricted support.)

Restriction: See Donor-imposed restriction.

Return on net assets ratio: Measures profitability based on net revenues by comparing a nonprofit's excess of support and revenues over expenses to its unrestricted net assets.

Revenue: Technically, income from providing goods or services to customers (clients, patrons, members, and so forth) and from other earning activities such as investments. Practically, is frequently used to include both earned income (from exchange transactions) and income from contributions.

S

Sarbanes-Oxley (SOX): A law passed by the U.S. Congress in 2002 in response to abuses in the for-profit business world. While generally applicable to public companies, SOX requires that nonprofit organizations have and ensure compliance with policies that prohibit retaliation against whistleblowers and prohibit alteration or destruction of documents that are relevant to a lawsuit or regulatory proceeding. In addition, SOX sets forth a number of good practices for all organizations, such as having an audit committee (with at least one financial expert) that is completely responsible for the relationship with the outside auditor.

Spending rate: One method of computing the amount of investment return to be considered as available for current use under the "total return approach."

Split-interest gift: General term used to describe various types of gifts under which the benefit of the resources involved is split between the donor (or other designated person) and a charity. Includes gift annuities, remainder trusts (annuity trusts and unitrusts), lead trusts, and pooled income funds.

Statement of Activities (also known as the **Income Statement):** A compilation of all revenues and expenses of a nonprofit organization; it also shows the excess or deficit of revenues over expenses and the change in net assets.

Statement of Cash Flows: Reports the sources and uses of the organization's short-term cash and cash equivalents for the period concurrent with the statement of activities. It is a summary of where the organization's cash came from and how it was used.

Statement of Financial Position (more commonly known as the **Balance Sheet**)**:** Represents and displays all of an organization's financial assets, liabilities, and net assets at a snapshot in time, usually the end of an accounting period (month, quarter, year), and conforms to the following equation: assets = liabilities + net assets.

Statement of Functional Expenses: Displays all income and expenditures according to their primary functional classifications, such as program services, management and general expenses, and fundraising.

Stipulation: An expression by a donor, in connection with a contribution or a promise to make a contribution, constituting a condition, a restriction, or both.

Support: Income derived by a nonprofit from contributions and grants.
Supporting expense: Expenses other than program expenses. Supporting expenses include management and general, fundraising, and, for a membership organization, membership development expenses.

T

Tax exempt: Literally, statutorily exempt from tax. Often erroneously used interchangeably with not-for-profit/nonprofit; the two terms have completely different meanings, although in practice they overlap considerably.
Temporarily restricted net assets: The part of the net assets of a nonprofit organization resulting from contributions and other inflows of assets whose use by the organization is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions of the organization pursuant to those stipulations.
Temporary restriction: A donor-imposed restriction that permits the donee to use up or expend the donated assets as specified and is satisfied either by the passage of time or by actions of the organization.
Term endowment: Temporarily restricted endowment. (See Endowment fund.)
Total return approach: A method of managing endowment assets in which a portion of capital gains is made available for current use under a formula approved by an organization's governing board.
Treasurer: The key volunteer financial role involving overseeing financial operations. Most nonprofits charge the treasurer with the legal responsibility for custody of the organization's funds and securities; keeping full and accurate account of all receipts and disbursements, the books, and financial records of the organization; and providing periodic reports to the full board. In smaller organizations, the treasurer may have hands-on responsibilities; in large organizations, the treasurer remains legally responsible for these functions, even though a staff member performs them.
Trending: The display and analysis of data or information over time.

U

Uncertain: Less than likely. Judgment is often required to assess whether the probability of an occurrence should be considered as uncertain versus likely.
Unconditional promise to give: A promise to give that depends only on passage of time or demand by the promisee for performance. (Contrast with Conditional promise to give.)
Unrelated business income (UBI): Income from a trade or business, conducted by a tax-exempt organization, that is not substantially related to the purposes for which the organization is exempt. Net income from such a business is taxable. (See Internal Revenue Code Sec. 512 and 513 for the precise definition.)
Unrestricted net assets: The part of net assets of a nonprofit organization that is neither permanently restricted nor temporarily restricted by donor-imposed stipulations.
Unrestricted support: Revenues from contributions that are not restricted by donors. (Contrast with Restricted support.)

W

Whistleblower: An employee, former employee, volunteer, or member of an organization who makes a good faith effort to disclose improper activities to those who have the power to take corrective action. The misconduct may be a violation of state or federal law, rule, or regulation; theft or misuse of organization funds; gross misconduct or inefficiency; or any condition that may significantly threaten the health or safety of employees or the public.