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What's the Big Deal With My Church's Financial Statements?

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†This is not a CPA firm.

*Assurance, attest, and audit services provided by Capin Crouse, LLC

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3 Main Points

1. Understanding your church’s financial statements.
2. Getting the most out of your financials.
3. Do I need an audit*? Levels of CPA services.

Understanding Your Church's Financial Statements

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Basis of Accounting Types

- **Accrual Basis** – Revenue is recognized when earned and expenses recorded when incurred.
- **Cash Basis** – Revenue is recorded when cash is received, and expenses recorded when cash is spent.
- **Modified Cash Basis** – Hybrid method. Revenue is generally recorded when cash is received and expenses recorded when cash is spent, but includes certain accrual-based items such as long-term assets, debts, and depreciation.

Financial Statement Titles

- Statement of Financial Position (Balance Sheet)
  - Net Assets without Donor Restrictions
    - Designated funds
  - Net Assets with Donor Restrictions
    - Time and/or purpose
    - Perpetuity
- Statement of Activities (Income Statement)
- Statement of Cash Flows
- Statement of Functional Expenses
  - Presented as a standalone statement or as a schedule in the footnote

Sample Statement of Financial Position

First Baptist Church	
12/31/25	
Checking	$5,234
Savings	$10,127
Investments	$0
Current Assets	$15,361
Land	$50,000
Building	$102,750
Equipment	$27,145
Less Depreciation	($10,577)
Net Fixed Assets	$169,318
Other Assets	$0
Total Assets	$184,679

Payroll Tax Liability	$744
Accounts Payable	$3,744
Copier Lease Current Portion	$4,800
Mortgage Current Portion	$9,600
Current Liabilities	$18,888
Copier Lease (Long Term Portion)	$11,200
Mortgage (Long Term Portion)	$80,010
Total Liabilities	$110,098
Net Assets:	
Net assets without donor restrictions	$72,581
Net assets with donor restrictions	$2,000
Total Net Assets	$74,581
Total Liabilities and Net Assets	$184,679

How Are Donor-Restricted Funds Handled?

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Net Asset Definition

- Two classes of net assets:
  - **Net Assets without Donor Restrictions –** This includes unrestricted, undesignated, board-designated, equity in PPE (fixed assets less debt associated with fixed assets)
  - **Net Assets with Donor Restrictions –**
    - Result from donor-restricted contributions for a specific period/time and purpose
    - Donor-restricted in perpetuity

Restriction Fulfillment

- Accounting policy regarding donor contributions received and spent in the same year
- Reclassifications – Transfers of net assets with donor restrictions to net assets without donor restrictions due to expenditures that result in fulfilling the purpose restrictions or the passage of time

Financial Statement Interpretation

- Net Assets without Donor Restriction Balance:
  - Review the statement of financial position (balance sheet) and compute the following:

Net Assets without Donor Restriction	$ 72,581
- Fixed asset balance	- $ 169,318
+ Debt collateralized by assets	+$ 89,610
Unrestricted, undesignated bal.	$ (7,127)

- If this is below zero, or has been decreasing in the past few years, that is a warning sign.

Financial Statement Interpretation

- Days of Expendable Net Asset Reserves:
  - How many days of operating expenses are available in net asset reserves

$$\frac{\text{Unrestricted, Undesignated Net Assets}}{\text{Total Expenses} - \text{Depreciation/Amortization}}$$

(In days: ratio*365)

- Recommended benchmark is greater than 60 days. Less than 30 days is a red flag.

Financial Statement Interpretation

- Days of Operating Cash/Investments on Hand to Fund Annual Cash Expenditures:

$$\frac{\text{Operating Cash and Investments}}{\text{Total Expenses} - \text{Depreciation/Amortization} + \text{Debt Principal Due Next Year}}$$

(In days: ratio*365)

- Recommended benchmark is greater than 90 days. Less than 60 days is a red flag.

Financial Statement Interpretation

- Liquidity Ratio:
  - Measures how the church's most liquid assets are able to cover current operating liabilities

$$\frac{\text{Operating Cash, Investments, and Accounts Receivable}}{\text{Current Liabilities – Deferred Revenue – Current Debt Expected to Be Refinanced Within the Next Year}}$$

- Recommended benchmark is greater than or equal to 2.0

Financial Statement Interpretation

- Net Cash Availability:
  - Measures the amount of cash/investments available for other uses after the church has satisfied its current obligations and net assets with donor restrictions

Total Cash/Investments – Current Liabilities – Net Assets with Donor Restrictions

- Recommended benchmark is at least one month’s worth of cash expenses. Any negative amount is indicative that the church is borrowing from funds with donor restrictions.

Sample Statement of Activities

First Baptist Church			
Year Ended 12/31/25			
	Without Donor Restrictions	With Donor Restrictions	Total
Support and Revenue:			
Contributions	$50,423	$27,000	$77,423
Interest Income	$32,000	$0	$32,000
Other Income	$1,774	$0	$1,774
Total Support and Revenue	$84,197	$27,000	$111,197
Net asset released from restrictions	$29,000	$(29,000)	$0
Expenses:			
Program services	$81,990	$0	$7,742
Management and General	$15,373	$0	$12,872
Fundraising	$5,124	$0	$2,755
Total Expenses	$102,487	$0	$102,487
Change in Net Assets	$10,710	$(2,000)	$8,710
Net Assets, Beginning of Year	$61,871	$4,000	$65,871
Net Assets, End of Year	$72,581	$2,000	$74,581

Financial Statement Interpretation

- Net Income Ratio:
  - Used to show if the results of the church's general operations are positive or negative

$$\frac{\text{Change in Net Assets Without Donor Restrictions}}{\text{Revenues Without Donor Restrictions}}$$

- Recommended benchmark is to be a positive balance in any given year

Financial Statement Interpretation

- Debt to Contributions Without Donor Restrictions:
  - Measures how many times debt is greater than annual contributions without donor restrictions

$$\frac{\text{Total Debt}}{\text{Contributions Without Donor Restrictions}}$$

- Recommended benchmark is less than or equal to 2.0

Financial Statement Interpretation

- Debt Coverage Ratio:
  - Used to determine how many times a church would be able to cover its current annual debt obligations from current operations

$$\frac{\text{Change in Net Assets Without Donor Restrictions} + \text{Interest Expense} + \text{Depreciation/Amortization}}{\text{Mandatory Debt Service Payments (Debt Principle + Interest)}}$$

- Recommended benchmark is greater than or equal to 1.25

Sample Statement of Functional Expenses

First Baptist Church				
Year Ended 12/31/25				
	Program Services	Management and General	Fundraising	Total
Staff Payroll Expenses	$41,689	$7,817	$2,605	$52,111
Missions Outreach	$6,194	$1,161	$387	$7,742
Facility Costs	$10,298	$1,931	$643	$12,872
Professional Fees	$2,204	$413	$138	$2,755
Office Expenses	$1,920	$360	$120	$2,400
Marketing and Promotion	$1,262	$237	$78	$1,577
Equipment	$11,879	$2,227	$743	$14,849
Depreciation	$5,757	$1,079	$360	$7,196
Other	$787	$148	$50	$985
Total	$81,990	$15,373	$5,124	$102,487

Sample Statement of Cash Flows

First Baptist Church	
Year Ended 1/31/25	
CASH FLOWS FROM OPERATING ACTIVITIES:	
Change in net assets	$8,710
Adjustments to reconcile change in net assets to net	
cash provided (used) by operating activities:	
Depreciation	$7,196
Change in operating assets and liabilities:	
Leases	$(725)
Payroll tax liability	$58
Accounts payable	$923
Net Cash Provided by Operating Activities	$16,162
CASH FLOWS FROM INVESTING ACTIVITES:	$0
CASH FLOWS FROM FINANCING ACTIVITES:	
Payments on mortgage	$(15,300)
Net Cash Used by Financing Activities	$(15,300)
Change in Cash and Cash Equivalents	$862
Cash and Cash Equivalents, Beginning of Year	$14,499
Cash and Cash Equivalents, End of Year	$15,361

Common Disclosures Within Nonprofit Financial Statements

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Common Footnote Disclosures

- Nature of the organization and description of major programs
- Significant accounting policies – Describes accounting policies for the significant financial statement areas
- Detailed breakdown of significant financial statement areas
  - Investments, fixed assets, net assets, debt, endowments, etc.
- Liquidity footnote – Financial assets available for general expenditures from within one year of the statement of financial position date

Do We Need an Audit? Levels of CPA Services

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Levels of CPA Services

- **Audit** – The highest level of assurance provided; also requires the most preparation and best understanding of the financial information

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

Levels of CPA Services

- **Review*** – A step down from an audit; primarily focuses on inquiries related to the financial information and analytical procedures to understand the reasonableness of the numbers
- **Compilation** – No assurance is provided, and the CPA is only responsible for bringing any obvious errors to management
- **Advisory/Consulting Services** – e.g., Church Assessment
  - Administrative and governance document reviews
  - Internal controls processes – How receipts and disbursements are processed
  - Financial statement accuracy, timeliness, relevancy
  - Tax matters review

Types of Public Accounting Engagements

Clarification on audits:

- **Internal** – This process can be performed by staff of an organization or outsourced to others
- **External** – Audit opinions can only be issued by certified public accountants (CPAs) who are currently licensed

Why Have an Audit or Review?

- **Bylaws** – Some organizational documents require the periodic involvement of an outside entity
- **Lender** – Loan covenants may include the need for an audit or review
- **Accreditation** – Either for some type of educational accreditation or involvement in a group like the Evangelical Council for Financial Accountability
- **Donors** – A large donor or foundation may require an audit before giving a significant gift
- It is a **best practice**

Before You Begin

- Do you need an audit?
  - Is a Review of Financial Statements a better value?
  - Consulting arrangement (internal controls process)
- Do you need a new auditor?
- Selecting an auditor:
  - Send a request for proposal (RFP)
  - Choose the firm
  - Sign an engagement letter

Tips for a Successful Audit

- Prep list
  - Understand what is requested
  - Have it ready before the auditors arrive
- Be realistic about how long it will take you to prepare
- Keep information up-to-date throughout the year

Tips for a Successful Audit

- Understand the auditors' needs (space, Internet connection, etc.)
- Be available
- Have your staff meet with the audit staff before you start

Management Comment Letter

- Purpose
- Content
  - Material weakness, significant deficiency, other
  - Current and prior-year comments
  - Audit committee matters
- Types of issues addressed
  - Internal controls
  - Best practices (policies, tax issues, expense reports)

Questions or comments?

Thank you!

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