



Why your nonprofit's internal and year-end financial statements may differ

Do you prepare internal financial statements for your board of directors on a monthly, quarterly or other periodic basis? Later, at year end, do your auditors always propose adjustments? What's going on? Most likely, the differences are due to cash basis vs. accrual basis financial statements, as well as reasonable estimates proposed by your auditors during the year end audit.

Simplicity of cash

Under cash basis accounting, you recognize income when you receive payments and you recognize expenses when you pay them. The cash "ins" and "outs" are totaled by your accounting software to produce the internal financial statements and trial balance you use to prepare periodic statements. Cash basis financial statements are useful because they're quick and easy to prepare and they can alert you to any immediate cash flow problems.

The simplicity of this accounting method comes at a price, however: Accounts receivable (income you're owed but haven't yet received, such as pledges) and accounts payable and accrued expenses (expenses you've incurred but haven't yet paid) don't exist.

Value of accruals

With accrual accounting, accounts receivable, accounts payable and other accrued expenses are recognized, allowing your financial statements to be a truer picture of your organization at any point in time. If a donor pledges money to you this fiscal year, you recognize it when it is pledged rather than waiting until you receive the money.

Generally Accepted Accounting Principles (GAAP) require the use of accrual accounting and recognition of contributions as income when promised. Often, year-end audited financial statements are prepared on the GAAP basis.

Need for estimates

Internal and year end statements also may differ because your auditors proposed adjusting certain entries for reasonable estimates. This could include a reserve for accounts receivable that may be ultimately uncollectible.

Another common estimate is for litigation settlement. Your organization may be the party or counterparty to a lawsuit for which there is a reasonable estimate of the amount to be received or paid.

Minimizing differences

Ultimately, you want to try to minimize the differences between internal and year end audited financial statements. We can help you do this by, for example, maximizing your accounting software's capabilities and improving the accuracy of estimates.

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