How to Read the *New* IRS Form 990

Peter Swords

www.npccny.org

NONPROFIT Coordinating Committee of New York

# Chapter 7

## What Can You Tell From Net Assets?

We turn now to Part X (Balance Sheet) on page 11, one of the two principal financial statements contained in the Form 990. (Accountants sometimes refer to the Balance Sheet as the Statement of Financial Position.) The other principal part is comprised of Part VIII (Statement of Revenue) on page 9 and Part IX (Statement of Functional Expenses) on page 10, which together in effect comprise the Statement of Activities. See Chapters 4 and 5.

In assessing an organization's ability to meet its financial exigencies in future years[1] you can tell a lot from the Balance Sheet. Sometimes balance sheets can be complicated to analyze and unfortunately space restraints do not permit more than a quick overview. However, where the balance sheet is straightforward, which will fairly often be the case, you do not have to be an expert in accountancy to learn some significant things about the filer whose Form 990 you are examining.

To begin with, Line 16 reports total assets and Line 26 total liabilities and so right away you can see at glance whether their filer's liabilities exceed its assets in which case it may be concluded that the filer is in bad financial shape. There may be a reason for the deficit but its presence surely suggests further inquiry. However, it will rarely be the case that total liabilities will exceed total assets.

To get a quick sense of the filer's financial condition, we recommend you look at Line 27 – Unrestricted net assets. Line 27 Column B - unrestricted net assets at the end of the year – provides you with some idea of the level of unrestricted resources the filer has to start the following year with to help support its activities in the future. If it appears that the filer ended the year with relatively few liabilities needing to be satisfied in the near future, then a sizeable amount

[1] We believe that evaluating a filer's ability to meet future financial conditions – will it have sufficient income to cover estimated expenses – is one of the main purposes of analyzing financial statements, such as the balance sheet.

reported at Line 27 Column B means that the filer will likely go into the next year with a cushion. If an analysis of Part VIII (Statement of Revenue) on page 9 suggests that income for the ensuing year is likely to be strong, or at least adequate to meet predicted expenses[2] – a fair idea of which can be derived from Part IX (Statement of Functional Expenses)[3] on page 10 – then one may conclude that in terms of financial health things look good for the filer in the near term.

What should always be of interest is whether the filer ran a surplus or deficit for the year. A filer may operate at a deficit for a particular year and still have its assets exceed its liabilities at the end of that year. Because it is on the first page of the Form 990, a reader looking to see whether the filer ran a surplus or a deficit for the year being reported on may look at the second column of Line 19 of Part I on page 1. This line reports total revenues less total expenses for the year being reported on. If revenues exceeded expenses it will mean that the filer operated at a surplus for the year, but, as explained in more detail in the next paragraph, the surplus may be accounted for in part by the receipt of what might be thought of as unusual sources of income such as multi-year grants or gifts to permanent endowments and thus may not give as reliable an indication of the filer's ability to proceed financially in the near future as can be gained by looking at Line 27 of the Balance Sheet at Part X[4] on page 11.

By comparing Line 27 Column A - unrestricted net assets at the beginning of the year and Line 27 B - unrestricted net assets at the end of the year, one can determine what the filer's surplus or deficit was for the year uninfluenced by sources of income which may be unusual. We have in mind the receipt of multi-year grants, the whole amount of which is reported as income in the year received, although only a part of the grant may be used in that year, or the release of income from multi-year grants received in prior years which amounts are not reported in income for the year being reported on.[5] Also in

[2] See Chapter 4 and Expansion on Part VIII.
[3] See Chapter 5.
[4] For example, if expenses exceeded revenues it will mean that the filer operated at a deficit for the year, but the deficit may be accounted for in part by the release of income from multi-year grants received in the past which income is not taken into account for the year being reported on and so, as suggested above, Line 19 may not give as reliable an indication of the filer's financial condition as can be gained by looking at Line 27 of the balance sheet.
[5] Multi-year grants are included on Line 12 of Part I on page 1 and so, as suggested above, the surplus or deficit shown at Line 19 on page 1 will reflect these receipts and may give a somewhat misleading idea of the filer's financial condition.

some cases the filer may have received assets for a permanent endowment in the year being reported on. This amount will also be included in income in the year the gift is made.[6] If the receipt of these kinds of income are considered unusual and thus as possibly giving a somewhat skewed income picture for the year being reported on,[7] at least in terms of the filer's near-term ability to proceed in a financially secure fashion,[8] by looking at Line 27 alone you in effect remove such income from the equation.[9]

If Line 27 Column B is greater than Line 27 Column A, it means the filer ran a surplus for the year. And a deficit if it goes the other way. If the surplus is sizable that may be taken as a sign of financial health. If you have access to the three latest Forms 990 and each year a surplus was achieved, that may be taken as more good news. Of course, deficits (where Line 27 Column A is larger than Line 27 Column B) point in the other direction. If the reader has access to the last three years of the filer's Forms 990 and observes such deficits each year, or worse, increasing deficits each year, that is likely to be reason for alarm. As mentioned, surpluses or deficits determined on the basis of Line 27 reflect how the filer ended the year without the affect of unusual sources of income and thus may be considered a more reliable predictor of the future.

In terms of assessing a filer's financial condition, it will surely be of interest if the filer reports multi-year grants at Line 28. (Line 28 also reports non-time restricted grants that were made to support specific purposes, e.g., to a produce a report). Despite the fact that such

[6] Gifts to a permanent endowment are included on Line 12 of Part I on page 1 and so, as suggested above, the surplus or deficit shown at Line 19 on page 1 will reflect these receipts and may give a somewhat misleading idea of the filer's financial condition.

[7] For example, if the filer received $700,000 in what might be thought of as ordinary or usual income (representing the kind of income the filer receives year in/year out), a multi-year grant of $300,000 (only $100,000 of which is to be spent in the year being reported on) and a gift of $1,000,000 for a permanent endowment, total income will equal $2,000,000 but of this amount only $700,000 would be what we have referred to as ordinary or unusual income. Line 12, however, would report $2,000,000. As suggested below, for some filers multi-year grants will not be unusual.

[8] For example as suggested in note 6 above, a large gift to a permanent endowment may cause Line 12 on Part I on page 1 to report an unusually large amount which will not be available for meeting expenses for near-term ensuing years.

[9] Many filers will not have multi-year grants which are reported at Line 28 as temporarily restricted net assets or permanent endowments which are reported at Line 29 as permanently restricted net assets. In these cases, Line 27 tells the whole story.

income may be unusual, their presence can only be considered a good thing. Furthermore some filers may receive frequent multi-year grants. This can be told by examining the filer's Forms 990 for the past three years. These circumstances may also be taken as reflecting favorably on the filer's financial health. If multi-year grants are usual for the filer, they might well be taken into account in assessing the filer's year-end surplus or deficit as reflecting on its ability to proceed in the future in a financially secure way.

Finally, some filers have permanent endowments, reported at Line 29 as permanently restricted net assets.[10] If this is so, it may be supposed that the permanent endowment is generating income which helps support some part or all of the filer's activities. And this is usually a good thing.

Net Assets or Fund Balances section from Part X of page 11:

| Net Assets or Fund Balances | | | | | |
|---|---|---|---|---|---|
| | | **Organizations that follow SFAS 117, check here ▶ ☐ and complete lines 27 through 29, and lines 33 and 34.** | | | |
| | 27 | Unrestricted net assets | | 27 | |
| | 28 | Temporarily restricted net assets | | 28 | |
| | 29 | Permanently restricted net assets | | 29 | |
| | | **Organizations that do not follow SFAS 117, check here ▶ ☐ and complete lines 30 through 34.** | | | |
| | 30 | Capital stock or trust principal, or current funds | | 30 | |
| | 31 | Paid-in or capital surplus, or land, building, or equipment fund | | 31 | |
| | 32 | Retained earnings, endowment, accumulated income, or other funds | | 32 | |
| | 33 | Total net assets or fund balances | | 33 | |
| | 34 | Total liabilities and net assets/fund balances | | 34 | |

Form **990** (2010)

If the filer reports endowments on Lines 28 or 29 of Part X, Part V of Schedule D may contain some interesting information. See Expansion on Endowments.

What has just been suggested should, as noted, be taken as a very general first approach. It is often the case that some of the net assets on hand at the end of the year may not be easily drawn down to meet a filer's needs or obligations. In talking about meeting the filer's needs, as suggested, we primarily refer to its near-term needs and by this we have in mind its needs for the next year or so. Obviously, in the longer-term future, if the filer became financially destitute and needed to liquidate any assets to satisfy its creditors, most of the

[10] Permanently restricted assets are assets that have been given with restrictions that they be preserved and not sold. One example would be an endowment gift that stipulates that the principal of the gift is to be permanently held and that only the income that the principal generates may be currently used. Another example would be a gift of a work of art or real estate with a restriction that it be held permanently and not sold. These permanently restricted assets therefore cannot be used to meet the general near-term needs of the filer.

assets that we are suggesting are not available to meet near-term needs might well be accessible to satisfy creditor demands. These points are elaborated on below.

To conduct the more searching analysis, it is necessary to look more closely at Part X (Balance Sheet) of the filer's Form 990. Part X is divided into three sections: Assets (Lines 1 – 16), Liabilities (Lines 17 – 26) and Net Assets (Lines 27 – 34).

As just mentioned above, a careful reader of the Form 990 will want to look at the Assets section of Part X to find out whether any of the assets held by the filer might be difficult to readily convert to cash (i.e., might not be easily liquidated). The Assets section of Part X lists various types of assets (Lines 1 – 15) roughly in order of their relative availability for use. For example, Line 1 reports cash (immediately available to pay expenses) and Line 10 reports the value of buildings and similar assets held by the filer. A building, whether it is a permanently restricted asset or an unrestricted asset, may as a practical matter be difficult to liquidate. The same may be said about certain assets the filer holds, such as intangible assets (reported at Line 14). So in assessing a filer's net assets to determine their availability to meet near-term needs, it may be desirable to review the kinds and relative amounts of assets that the filer reports in the Assets section (Lines 1 - 15) of Part X.[11]

Attention should also be paid to the Liabilities section of the Balance Sheet (Lines 17-26). Similar to the way assets are reported, liabilities are listed roughly in order of when they are to be paid. If the filer reports a large amount of accounts payable at the end of the year (Line 17 Column B), this may mean difficulty in the ensuing year when at least some of these debts are required to be paid. Long-term loans may be less troubling. More generally, if the filer reports large amounts of liabilities and if a comparison of several years of a filer's Forms 990 show increasing liabilities, this may reflect an unhealthy

[11] Line 15 reports Other assets. If the amount reported at Line 15 is 5% or more of total assets reported at Line 16, the filer is required to complete Part IX of Schedule D (Supplemental Financial Statements) where the assets are described and their book value is reported. If a sizeable amount of assets (5% or more of total assets) is reported at Line 15, to adequately understand the balance sheet, Part IX of Schedule D should be carefully reviewed.

financial situation and be taken as a reason for making further inquiry.[12]

[12] Line 25 reports Other liabilities. If an amount is reported at Line 25, regardless of the percent of total liabilities, the filer is required to complete Part X of Schedule D where the liabilities are described and their amount is reported. If a sizeable amount of liabilities is reported at Line 25, to adequately understand the balance sheet, Part X of Schedule D should be carefully reviewed.