A Quick Guide to Nonprofit Surpluses and Deficits

6 min read

Key Takeaways

- In a nonprofit, the figure represented on the bottom line is not always as cut-and-dry as in a for-profit due to the concept of restricted funds. Restricted funds are those which have been earmarked for certain uses or have a time restriction in place.
- If your bottom line reveals a surplus, your next step is to determine whether or not the surplus contains restricted funds.
- Deficits often occur due to overly optimistic budgets and overhead costs, your nonprofit's indirect expenses. This is why it’s important to have timely and accurate financial reporting.

Nonprofits should be run like a well-run for-profit. The difference is you reinvest those profits back into the mission instead of distributing to the owners.

In the for-profit world, we call them "profits" and "losses," but in a nonprofit organization, the number represented on the bottom line of your organization's Statement of Functional Expenses (Income Statement) is either a surplus (a positive figure) or a deficit (a negative figure).

At year-end, when a nonprofit has a surplus, it means it ended the year bringing in more money than was spent, and a deficit typically means the organization did not meet the spending, fundraising or budget goal outlined by its finance committee.

In a perfect nonprofit world, with 100% predictable spending and fundraising, year-end balance sheets would show exactly zero on the bottom line. The real world, unfortunately, does not work this way.

A nonprofit can have a surplus at the end of the tax year, and although it is not usually desirable, it can sometimes be okay for a nonprofit to have a deficit.

What is truly important is that the executive director, finance committee and board of directors all understand the implications of both outcomes and how to make the best decisions to handle either scenario.

When Your Bottom Line... Isn't Really Your Bottom Line

Restricted Funds

In a for-profit company, the bottom line is truly its bottom line – the cash left in the business after all obligations have been paid. A for-profit's bottom line is money that is free to pay out in investor dividends or to re-invest in growing the company.

In a nonprofit, the figure represented on the bottom line is not always as cut-and-dry as in a for-profit due to the concept of restricted funds. Restricted funds are those which have been earmarked for certain uses or have a time restriction in place.

There are several different types of restricted funds, including:

- **Temporarily Restricted Funds** - These funds usually come from grants and are restricted for a certain purpose or a time limitation, such as the completion of a project.
- **Permanently Restricted Funds** - These types of funds are usually in the form of endowments. The principal amount of permanently restricted funds remains intact to be invested so an organization can continue to benefit from the investment income.
- **Solicited Donations** - When donations are solicited for a specific purpose or program, they become restricted funds, meaning they are earmarked for those specific programs. For example, if a church solicits donations specifically for a building improvement, then the donations must go toward that improvement.

If excess funds exist, donors should be contacted for permission to reallocate funds. To prevent this bookkeeping quagmire, an organization can indicate on donation materials that excess funds will go to a secondary cause.

- **Unsolicited Donations** - These donations are not raised as part of a specific fundraising campaign, but rather are given independently to an organization. For example, a parent might donate money to a school, indicating that it should be put toward supplies for a certain grade. These funds then become restricted and would need to be considered a resource for only the grade level indicated.

Each of these types of restricted funds is included in a nonprofit organization's bottom line. Although it is okay to keep both restricted and unrestricted funds in the same account at the bank, you do have to keep careful track of the two categories.

To understand how much-unrestricted cash your organization actually has in its bottom line, it is essential that you carefu**lly track restricted funds as your organization receives and spends them.**

Recording and Receiving Revenue

In addition to restricted funds, the time which elapses between recording and receiving revenue can also create a misleading bottom line.

The Financial Accounting Standards Board® requires nonprofits to record revenue from contributions and unrestricted grants when they receive approval or a commitment from a donor – not when the nonprofit receives the money. As a result, your bottom line might reflect funds that have been pledged for which your organization has yet to receive. This timing issue can lead to both misleading surpluses and deficits, depending on when the revenue is recorded and when it is received.

For example, consider an organization that records revenue from a grant in 2018, and receives it in 2019. Then the organization renews the grant for 2020 in January of 2020. This would potentially leave the organization's 2019 balance sheet with an apparent deficit due to the timing of recording and receiving funds.

Celebrate Good Times! What to Do if Your Nonprofit Has a Surplus

If your bottom line reveals a surplus, go ahead and celebrate. Then determine whether or not the surplus contains restricted funds. If any restricted funds come from grants, be sure you have not exceeded any time limitations. If you are in danger of losing funding, find out whether or not you qualify for a no-cost extension.

If you have surplus unrestricted funds, you have several options regarding what you can do with the money:

1. **Save It** - You can always keep excess funds on hand to help cover a future deficit or unforeseen expense.
2. **Pay Down Debt** - Getting ahead on debt will reduce your interest expense and bring you closer to being debt-free.
3. **Reward Employees** - Use your excess cash to recognize employees who have gone the extra mile.
4. **Invest in Your Mission** - Use the money to expand a program, offer a temporary program, expand your footprint, bolster fundraising efforts or improve your nonprofit's assets.

Breaking It to the Board: How to Handle a Budget Deficit

Although they don't always signal the end, deficits should be taken seriously. If you have one, it's important to understand why you have it and whether it is a one-time issue or a recurring problem. Then you need to determine how to address the deficit. You have to figure out how you will come up with additional funds to cover the shortage.

Deficits often occur due to overly optimistic budgets and overhead costs, your nonprofit's indirect expenses. Let's face it, most donors aren't excited about allocating contributions to cover the cost of your utilities, paper towels or bathroom supplies.

If you have a deficit, first take a look at the spending rate on your government contracts and grants and consider whether or not you are properly allocating indirect costs for reimbursement.

A deficit, which didn't occur due to a one-time problem like a burst pipe, means you might have to make tough decisions to ensure the future of your nonprofit. Consider whether you might have to end a program and/or reduce your staff. Come up with a few plans to lower expenses and present them to your board of directors.

Data-Driven Decisions: Comparing Budget Versus Actual to Keep a Bead on Programs

In order to effectively manage the intricacies of a nonprofit's finances, it is essential the executive director, finance committee and board of directors have access to accurate and timely financial reports. A smart back office and sound financial management system, which GrowthForce can provide, will ensure your nonprofit has the tools necessary to create sound annual and program budgets, strategic plans, employee policies, internal controls, and accurate cash flow projections. Without these essential financial resources, your organization increases the risk of over-spending, cash-flow issues, and not fulfilling your mission.