

Researching a Nonprofit: Financial Resources

Document	Why it's important	Where to find it
IRS Publication 78	Confirms that the organization is eligible to receive tax-deductible charitable contributions	Exempt Organizations Select Check on the IRS website
Annual report	Includes an overview of the organization's finances, including a breakdown of revenues and expenses, sources of income, and any changes over the past year (such as investments in infrastructure or the sale of assets)	The nonprofit's website or GuideStar , which curates information such as annual reports and financial documents—but note that this database is not a comprehensive survey of all nonprofits
Form 990, a nonprofit's tax return	Helps answer questions such as: "How much income did the filer receive and from what sources?" and "Who are the filer's board members?" For a guide to interpreting the Form 990, see: How to Read the IRS Form 990 & Find Out What It Means	The Form 990 is publicly available and can be found on the nonprofit's website or GuideStar For an overview of filing requirements for the Form 990, see this update by Independent Sector .
Financial audit	Helps you to assess the organization's financial security based on its cash situation. Footnotes prepared by the auditor can help the reader to interpret the balance sheet, income statement, and cash flow statement. For more detail on financial audits, see next page.	Request from the organization; sometimes included in the annual report

Researching a Nonprofit: Financial Audit Information

A **financial audit** (for all organizations with annual revenue over \$500K) and **memorandum on internal controls**—more familiarly known as the **management letter**—should be available by request from the organization.

The **financial audit** can be considered a “trriage tool” that will help you to assess the organization’s financial security based on its cash situation. The audit includes footnotes prepared by the auditor to help the reader interpret the balance sheet, income statement, and cash flow statement. The footnotes pertain to significant accounting policies and often help to explain issues such as in-kind donations, the relative liquidity of assets, etc. (For example, a food bank may appear to have \$3.5 million in revenue, when \$3 million of that consists of in-kind food donations that cannot be used to support the organization’s infrastructure.)

An organization will receive a **management letter** if the auditor has comments for the board or financial management team. It is common for nonprofits to receive at least one comment. The comments are classified as “deficiency,” “serious deficiency,” and “material weakness,” and will give you a sense of the areas in which the organization can improve.

- “Deficiency” generally indicates that the organization has made minor mistakes in its financial processes. These comments signal areas for improvement or issues where the auditor has identified potential for error, even if no errors have occurred yet.
- “Significant deficiency” generally indicates that the organization has made more serious errors or has received more than one comment. It is important to note that the auditor has the right to increase all “deficiency” ratings to “significant deficiency” if the organization receives more than one comment of any kind. By asking neutral questions of the organization, try to understand if the comments add up to a larger issue with the organization, or if they note problems that are not related to each other.
- “Material weakness” generally indicates that the organization lacks financial capabilities. These comments are sometimes noted if an organization has to issue a restatement for an accounting error made in a previous year. A “material weakness” is a significant problem and it would be worth engaging the organization in an extensive discussion.

Helpful Hint

It may be helpful to request management letters over several years in order to evaluate whether the organization struggles with the same issues year after year.