

FINANCIAL LITERACY

Understanding Financial Statements for Non-Financial Not-for-Profit Directors

Presented by [presenter's name]

An Educational Session sponsored by the Chartered Professional Accountants of Canada (CPA Canada)





Understanding Financial Statements for Non-Financial Not-for-Profit Directors

Agenda

Board's Role

- Fiduciary Duties Related to NFP Financial Oversight
- Common Barriers To Full Participation in Financial Oversight
- Roles and Responsibilities of Management, Board and Auditor

Key Accounting Concepts & Reports

- Financial Reporting Process
- Financial Reporting Concepts
- Accounting for Contributions (i.e., Donations)
- Four Key Financial Statements
- Fund Accounting
- Auditor's Opinion
- Conclusion: Your Role as NFP Director



Overseeing financial affairs: Every director has a fiduciary duty

"Overseeing the financial affairs of NFPs is a key responsibility of the board, and of every member of the board."

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Common barriers to full board participation in financial oversight

- We have an experienced accountant on our board
 why should I have to deal with this?
- 2. Shouldn't the board be focusing on our organization's mission?
- 3. Accounting is just too complex for me!
- 4. Isn't this the job of the auditor or of management?



Roles and responsibilities of financial reporting

Management

- Prepares financial reports
- Exercises judgment on how certain items are treated
- Develops internal financial controls

Board

- Oversees management's financial reporting processes
- Satisfies itself as to appropriateness of financial reports
- Oversees appropriateness of financial controls

Auditor

- Provides independent assessment of the financial statements
- Gives a professional opinion on the financial statements

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Board - Auditor relationship

Two Key Considerations:

- 1. Choice of Auditor
 - Board selects the auditor
 - Board recommends appointment at the AGM

2. Auditor Reporting Relationship (Governance Best Practices)

- Auditor reports to the board (or board committee)
- Auditor meets with the board (or board committee) in camera, w/o management



Internal financial reporting process

- 1. Staff both create and use financial reports
- 2. Certain financial reports are submitted to the board and/or board committees
- 3. A "natural cycle" of financial reporting to the board:
 - Budget for the coming year
 - Audited statements for the previous year
 - Internal in-year financial reports
- 4. Calendar dates depend on the organization's fiscal year

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External financial reporting process

- Stakeholders have an interest in your organization's financial affairs:
 - Funders
 - Donors
 - Members
 - Canada Revenue Agency (CRA)
 - · Others
- Common information requirements are often met through the audited statements and annual report
- Special purpose reports are sometimes required (e.g., funders, donors, CRA)
 - Management prepares
 - Board may oversee



Financial reporting concepts - Assets

Definition: Things owned by or owed to the NFP

Current assets: Cash or items expected to be cash or utilized within 1 year, such as

- Cash in the bank
- Cash equivalents
- Accounts receivable

Long-term assets: beyond 1 year, such as

- Capital assets (e.g., buildings, equipment)
- Investments

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Financial reporting concepts – Liabilities

Definition: Amounts owed to others

Current liabilities: payable within 1 year, such as:

- Accounts payable
- Bank loan
- Current portion of mortgage payable

Long-term liabilities: payable beyond 1 year, such as:

Mortgage payable (excluding current portion)



Financial reporting concepts – Revenues

Definition: Amounts associated with increases in economic resources related to its operating activities, such as:

- Grants
- Contributions (donations)
- Fee-for-service which generates revenue
- Membership fees
- Sale of goods
- Investment Income

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Financial reporting concepts – Expenditures

Definition: Amounts spent related to operating activities, such as:

- Salaries
- Rent
- Office supplies
- Depreciation of capital assets (usually called "amortization of capital assets")



Financial reporting concepts – Net revenues

Net Revenues = Total Revenues – Total Expenditures

- If positive, called Excess of Revenues over Expenditures (an "operating surplus")
- If negative, called Deficiency of Revenues over Expenditures (an "operating deficit")

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Contributions – A special type of revenue

Accounting term for donations is contributions

Definition: Contributions are non-reciprocal transfers

- The contributor does not receive anything in exchange for the contribution
- Unique to NFPs
- Can be a significant percentage of an NFP's revenues
- Government funding is considered to be a contribution

Three types of contributions

- Restricted Contribution Externally imposed conditions as specified by the donor
- 2. Endowment Contribution A restricted contribution with the stipulation that the resources be maintained permanently
- 3. Unrestricted Contribution
 - · No externally imposed conditions
 - · Organization is free to use the funds as it sees fit



Contributions – Accounting methodologies

NFPs are required to distinguish between contributions and other revenues

- Must report on contributions in financial statements
- Must report on each type separately

Two methods of accounting for contributions, which affects when revenue is recognized:

- Deferral Method
- 2. Restricted Fund Method

Choice of method:

- Can choose either method if NFP receives externally restricted contributions
- Must choose the Deferral Method if NFP does not receive externally restricted contributions

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Contributions – Deferral method of accounting

General principle for Deferral Method:

 Contributions are taken into revenues when related expenditures are incurred, not when the contributions are received

Accounting Requirements under Deferral Method:

- Tracking of both contributions recorded and when related expenditures made
- Distinguishing contributions for capital and contributions for operations
- Tracking amortization of contributed capital assets separately
- Accounting for three types of contributions (restricted, endowment, unrestricted)



Contributions – Restricted fund method of accounting

General principle for Restricted Fund Method

 A contribution is taken into revenues of a restricted fund when the contribution is recorded, not when the expenditure is made

Accounting Requirements for Restricted Fund Method

- Requires at least one externally restricted fund Contributions included as revenues in the current period
- Non-restricted contributions are accounted for in a "general fund" or "operating fund" - general fund uses the Deferral Method
- Restricted contributions that do not correspond to any restricted fund are accounted for in the general fund
- Endowment contributions require an "endowment fund" (separate restricted fund)

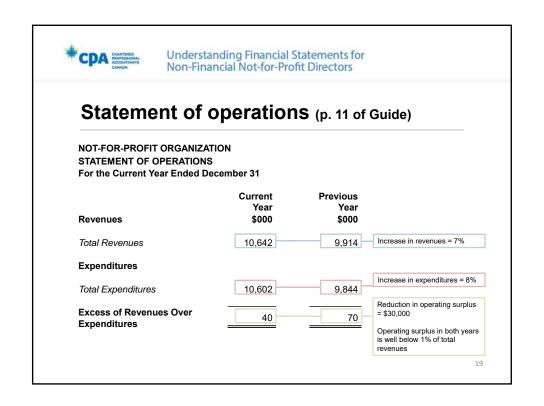
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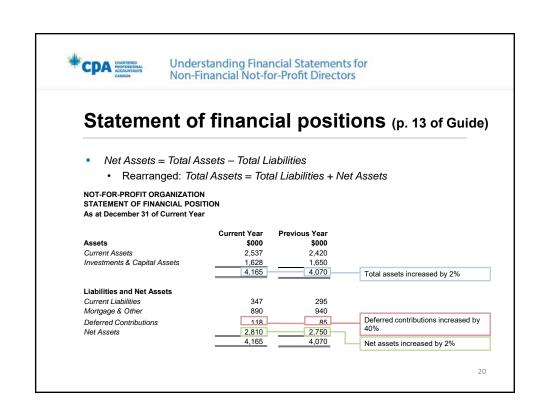


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Key NFP financial statements

- 1. Statement of Operations (Pg.10)
 - Sometimes called an "Income Statement"
 - Summary of transactions over a defined period of time
- 2. Statement of Financial Position (Pg. 12)
 - Sometimes called a "Balance Sheet"
 - Financial status at a point in time
- 3. Statement of Changes in Net Assets (Pg. 21)
 - Identifies categories of net assets
 - Changes in each category over a period of time, to determine final balances at a point in time
- 4. Statement of Cash Flows (Pg. 24)
 - Focuses on cash
 - How cash is generated; how cash is used







Statement of financial positions (p. 13 of Guide)

- Working Capital = Current Assets Current Liabilities
- Working Capital Ratio = Current Assets / Current Liabilities

NOT-FOR-PROFIT ORGANIZATION STATEMENT OF FINANCIAL POSITION As at December 31 of Current Year

	Current Year	Previous Year
Assets	\$000	\$000
Current Assets	2,537	2,420
Investments & Capital Assets	1,628	1,650
	4,165	4,070
Liabilities and Net Assets		
Current Liabilities	347	295
Mortgage & Other	890	940
Deferred Contributions	118	85
Net Assets	2,810	2,750
	4,165	4,070

Working capital increase = \$65,000

Working capital ratio decreased from 8.2 to 7.3

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Statement of changes in net assets (p. 23 of Guide)

Net Assets are disaggregated into categories, reflecting the categories in the Statement of Financial Position:

- Invested in Capital Assets (optional disclosure)
- Endowments (restricted by donors to maintain the capital permanently)
- Internally Restricted (restrictions imposed by the board)
- Unrestricted (no restrictions at all)

Statement shows the changes over a period of time (e.g., fiscal year) via a "matrix" presentation:

- Columns are the net asset categories
- Rows are the changes from opening balance to closing balance



Statement of cash flows (p. 26 of Guide)

Identifies cash provided by, or used in, three areas over the year:

- Operations
- Investing activities
- Financing activities

Some accounting entries in previous statements do not involve cash, such as:

- Amortization of capital assets is an expenditure, but no cash outlay
- Accounts receivable is an asset reflecting revenues, but no cash received
- Amortization of deferred contribution increases current revenues, but cash received in a previous period

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Fund accounting (p. 28 of Guide)

- An optional method of tracking restricted contributions and internally restricted net assets
- Each fund has its own revenues and expenditures, assets and liabilities, and net asset balance (called "fund balance")
- NFP formally establishes funds segregated by purpose, such as
 - Capital Assets
 - Endowments
 - Operations
- Funds are typically presented as columns in the financial statements
 - Statement of Operations and Fund Balances
 - Statement of Financial Position
 - Statement of Cash Flows
- Under fund accounting, the NFP can choose the method of accounting for contributions:
 - Deferral Method
 - Restricted Fund Method
- If your NFP is using fund accounting, consult the Guide



Year-End Audited Financial Statements – Auditor's Opinion (p. 35 of Guide)

- 1. Auditor reviews what management prepares:
 - Gathers "audit evidence"
 - Assesses internal controls and procedures
 - Reviews accounting policies
- 2. Key question auditor will answer:
 - Do the financial statements paint a picture that is a fair presentation of the organization's financial position and results of operations?
- 3. Report contains three elements:
 - Audited financial statements
 - Accompanying notes
 - Auditor's opinion
- 4. Two versions of the auditor's opinion:
 - Unqualified
 - Qualified

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Conclusion - Your role as a director

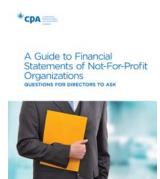
"You do not have to be a financial expert, but you do need to question and probe management and the auditor until you are satisfied your issues have been addressed."

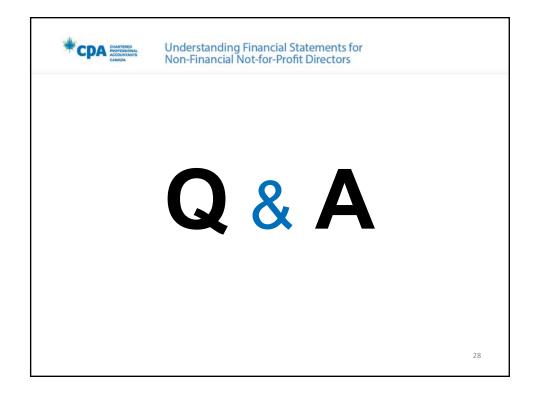
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Resources

 A Guide to Financial Statements of Not-For-Profit Organizations (NFPs): Questions for directors to ask cpacanada.ca/ financialliteracy publications







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