

Accounting Athletics



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The views in these handbooks are entirely the authors' own, and may not reflect the views of HRSDC, Vancity or any other partner organizations.

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Table of Contents

1. Introduction	7
2. Responsibilities of the Finance Committee	9
3. Roles of the Treasurer, Executive Director, accountant and Finance Committee member	11
The challenges of not-for-profit financial management	11
Role of the Treasurer	11
Role of the Executive Director	11
Role of the accountant / bookkeeper	13
Responsibilities of the Treasurer / Finance Committee member	14
Selection of the auditor	14
Options for reporting	
4. Accounting best practices	19
What are generally accepted accounting principles	19
What GAAP principles should you pay closest attention to?	21
Accounting management	27
Tools for managing books	27
General ledger and audit trails	28
Internal controls	29
Segregation of duties	31
Authority and authority leaks	32
Keeping your organization out of hot water	35
Changes to accounting best practices	40

5. Financial statements	43
Importance of quality, timely and reliable financial statements	43
Statement of financial position	44
Statement of Changes in Net Assets	45
Statement of Operations	45
Statement of Cash Flows	46
Notes to financial statements (also known as notes and disclosures)	46
Troubled Society Financial Statements	47
Comments on Troubled Society Financial Statements	55
Glossary of Terms	61
Resources	68
The Canadian Revenue Agency	68

Financial Fitness by Vancity

The *Financial Fitness* series was developed by Vancity credit union to assist small and medium-sized not-for-profits and co-operatives to acquaint themselves, or reacquaint themselves, with the basics of operating a financially healthy and resilient organization. Not-for-profits always operate in the arena of change and uncertainty. The Sector Monitor published by Imagine Canada reported in October 2012 that charity leaders generally predicted increased challenges in the year ahead. Research done by the Ontario Trillium Foundation indicates the best way to support not-for-profits is to assist in developing resiliency, so not-for-profits can bounce from moment to moment and opportunity to opportunity.

The goal of the *Financial Fitness* series is to help with that resiliency, and in particular, to demystify some of the key financial, legal and accounting concepts which sometimes keep not-for-profits from feeling in control of their destinies, or speaking truth to power when dealing with allied professionals and funders.

Legal Limberness addresses the fundamental legal issues, from the duty of care to statutory obligations, for which the Board of Directors and senior staff (Executive Director and program managers) are responsible.

Accounting Athletics addresses the role and responsibilities of the Board and more specifically, the Finance Committee – the Treasurer, Executive Director, Accountant or Bookkeeper – in reading financial statements, what to look for and when to be concerned.

Cashflow Calisthenics focuses primarily on the roles and responsibilities of senior staff to maintain the financial well-being of a not-for-profit organization. It includes advice on cash flow planning and developing “what-if” scenarios, and provides guidance on how to work with allied professionals to improve cash position.

Enterprising Exercises supports the staff and board of organizations that are currently operating a social enterprise. It poses important operational questions, and provides tools and success metrics to help identify areas where a social enterprise could be made stronger or more focused.

Each of these four handbooks fits within the overall framework of *Financial Fitness*, an introductory course for improving the financial health and resiliency of not-for-profit organizations.

Canada’s not-for-profit and voluntary sector is the second largest in the world, according to Imagine Canada. The full charitable and not-for-profit sector (including hospitals and universities) is the 11th largest contributor to Canada’s gross domestic product (GDP) and plays a vital role in our country’s economy, in addition to providing critical services to people and strengthening communities.

In 2007, Statistics Canada changed the way it tracks not-for-profit organizations in Canada, breaking the sector into three industry sectors:

- non-profit institutions serving households (NPISH), about 22% of all not-for-profits by GDP (religious, welfare, arts, entertainment, recreation, educational services and 'other');
- corporate sector, about 13%; and
- government sector, 65% of all not-for-profits (hospitals, universities and colleges).

In 2009, the NPISH sector alone accounted for \$22.1 billion of GDP activity and employed almost 529,000 people. Overall, the not-for-profit sector in Canada employs two million people and accounts for \$106 billion of the GDP.¹

That information alone is exceptional, but when layered with the fact that fully 54% of Canadian not-for-profits and charities are run entirely by volunteers – the collective accomplishments of these 161,000 organizations are truly awe-inspiring.

In British Columbia there are over 20,000 not-for-profit organizations, about half of which are also registered charities. Across BC, 1.5 million people volunteer, including on boards.

Common to all organizations are challenges of having stable funding (two-thirds of organizations experience this), planning for the future (55% of organizations experience this) and having enough volunteers, particularly at the board level (50% report this as an issue).

We hope these handbooks help build that core of financial health and resiliency of individual not-for-profits, and contribute to the collective financial fitness of the not-for-profit sector.

The *Financial Fitness* series is not meant to replace qualified financial, accounting or legal advice from professionals, but we hope these handbooks and the affiliated workshops will contribute to the collective financial fitness of the not-for-profit sector.

1 For more information and not-for-profit statistics see, www.hrcouncil.ca/documents/LMI_moving_forward.pdf and www.imaginecanada.ca/node/32



1. Introduction

Generally speaking, not-for-profit organizations embrace the importance of having Board members who are familiar with the programs delivered by the organization and who are committed to supporting the community with the not-for-profit serves. Board members are most often recruited for this experience and these values.

However, it is equally important to the oversight of any organization to recruit Board members who can read financial statements and who can explain them to the rest of the Board: individuals such as bankers, accountants and business people.

If your organization is currently operating without a Board member who has a financial background, tasking your nomination committee with attracting such a person would be a very good idea. Even without such an individual, training existing Board members and staff management in the financial areas of operating, managing and governing your not-for-profit is an important foundation to improve the financial sustainability of your organization.

This handbook is for all of the people – Board members-at-large, the Treasurer, the Board Chair and the Executive Director – who sit on a Finance Committee and could use some help understanding what your organization’s accountant is doing and why.

Accounting Athletics

Roles and responsibilities

- **Community support**
- **Program familiarity**
- **Financial literacy**



2. Responsibilities of the Finance Committee

If your organization does not have a Finance Committee or Executive Committee, set one up now! The five essential responsibilities of a Finance Committee that should be embraced by every not-for-profit, no matter the size, are:

1. To advise the Board of Directors from time-to-time about the financial position of the organization and the adequacy of its resources to meet long-term goals.
2. To advise the Board if problems with budgets or policies are foreseen.
3. To oversee the development and implementation of the budget.
4. To ensure the organization's financial resources are used in a cost-effective manner.
5. To support the strategic direction and to carry out policies of the Board of Directors.

Practically speaking, this means that, as a member of a Finance Committee – be it as staff person or Board volunteer – your key tasks include:

- Reviewing the way the budget is developed and assessing the impact of the budget on the operations of the organization.
- Coordinating with staff for the presentation of the annual budget to the Board (and sometimes broader membership) and recommending it for approval.
- Monitoring monthly revenue and expenses and assessing variances to the budget.


Strong Finance Committee

- **Reads,**
- **interprets, and**
- **explains financial statements**

Finance Committee responsibilities

1. **Advise Board about financial position**
2. **Advise Board of problems**
3. **Oversee budget development and implementation**
4. **Ensure funds are used cost-effectively**
5. **Support Board's strategic direction and policies**

- Reviewing all financial statements and reporting on financial activity to the rest of the Board – in particular, advising the Board of potential problems in developing or meeting budget objectives or other financial benchmarks.
- Reviewing and approving the accounting policies (in some organizations the full Board does this).
- Approving policies for the effective handling of investments and reviewing the management and assessing returns from investments.
- Developing long-term financial planning information.
- Monitoring internal controls and getting assurance that controls are being followed.
- Ensuring organizational funds are being spent appropriately (for instance, restricted funds are being used only for the purpose intended).
- Working with the strategic planning committee to apply a financial lens to future plans and options to address challenges.
- Appointing auditors and meeting with the auditors annually to review any relevant observations or findings, and discussing the auditors' management letter and the management response (many organizations set-up a separate audit committee for these tasks).
- Ensuring all annual paperwork is submitted to provincial and federal bodies.



3. Roles of the Treasurer, Executive Director, accountant and Finance Committee member

The challenges of not-for-profit financial management

Management guru Peter Drucker has ranked not-for-profits among the most challenging organizations to run because of the complexity of both defining their mission and meeting the expectations of many stakeholders with differing views. While for-profit entities have the sole, legal mandate to ensure shareholders get the best financial return on investment, not-for-profit organizations must balance both their financial bottom line and achieving social, community and environmental mandates as well. In this complex environment, effective planning and priority setting to allocate and manage financial resources is critical. The key financial responsibilities fall to some key individuals: the Board Treasurer, the Executive Director and the accountant. This team should be supported by others, in particular, the Board Chair, the Executive Committee and other interested Board members. These are the people who should comprise the Finance Committee.

Challenges of not-for-profit financial management

- **For-profits focus on: Return on investment**
- **NFP focus on: Protecting bottom line to ensure service delivery**

Key team members

Board Treasurer
Executive Director
Accountant

Role of the Treasurer

Role of the Treasurer

- **Ensure legal responsibilities detailed in bylaws are met**
- **Leadership of Committee**
- **Administrative (signatures, bookkeeping, banking)**
- **Report to Board to support sound decision-making**

The legal role and responsibility of the Treasurer for your specific not-for-profit should be outlined in your organization's bylaws. The Treasurer plays a leadership role in ensuring that all of the responsibilities of the Finance Committee are met and in most cases, also assumes the role of chairing the Finance Committee meetings.

From an operational perspective, the Treasurer is often given signing authority for cheques where two signatures are required. In small organizations the Treasurer may be called on to actually do the bookkeeping and handle the day-to-day banking.

The main responsibility, however, is to the rest of the Board: ensuring that they receive accurate and timely financial information so that together the Board can make sound decisions for the organization they govern.

Role of the Executive Director

Role of the Executive Director

- **Provide timely and accurate financial reports and advice**
- **Review records and projections**
- **Diversify revenue and control expenses**

It is the Executive Director's responsibility to ensure that the Board of Directors receives timely and accurate information about the state of your organization's finances. Specifically, the Executive Director must ensure that the Treasurer and Board receive regular reports that include the balance sheet, monthly income statements, year-to-date income statements with budget comparatives and variances, as well as an annual budget and other financial reports as needed.

The Executive Director may also want to see and approve bank reconciliation details, aged receivable information, aged payable information, payroll, and twelve-month cash flow projection.

Role of the accountant / bookkeeper

Role of the accountant/ bookkeeper

- **Responsible to the Executive Director**
- **Overall financial management**
- **Prepare and submit timely and accurate reports and budgets**
- **Recommend policies and procedures**

The accountant/bookkeeper is responsible to the Executive Director for providing the overall financial management of the organization and guiding the Finance Department to ensure that activities are carried out in an effective and efficient manner. While direct responsibility is to the Executive Director, the accountant/bookkeeper often has a dotted line reporting relationship with the Treasurer for explaining and reporting financial information.

As the lead staff person in developing budgets, the accountant/bookkeeper's planning responsibilities include the preparation of timely and accurate short- and long-term financial plans, identifying and preparing information and reports for the Executive Director and the Executive and Finance Committees, recommending financial and investment policies,

developing variance reports, identifying and recommending corrective action if required, and monitoring implementation.

Other responsibilities include recommending financial procedures and monitoring compliance, preparing information for the auditor, implementing investment strategies and procedures, and ensuring appropriate insurance coverage is in place based on expert advice.

Responsibilities of the Treasurer / Finance Committee members

As Treasurer or as a member of the Finance Committee, what can you do to ensure you are fulfilling your responsibilities to the not-for-profit you support?

Recommended actions

1. Know the business of your organization. Understand the work your organization does and how it fulfills its mandate. Learn how to assess the risks associated with the work you do and develop methods to mitigate these risks. Look both at your own successes and failures and those of similar organizations and make note of how these are assessed and communicated, both internally and externally.
2. Develop a culture of trustful scepticism. Not-for-profits tend toward trusting and collaborative relationships. However, there should be opportunities for intelligent scepticism – a mechanism or a person to ask difficult questions, provide the reality check and test the conventional wisdoms and myths. Because of training and position in the organization, the role of trustful sceptic often falls to the finance person. This role can be made easier by removing personalities and developing fact-based, decision-making processes.
3. Ensure the Board Nominating Committee keeps the need for the finance area in mind. One of the most important vehicles for the long-term health of any not-for-profit is having an active and forward-looking Nominating Committee that understands the skills needed to create a solid Board of Directors with qualified people to assume the role of Treasurer. Start the annual recruitment process early.
4. Keep your eye on both the financial and non-financial information. Staying informed on financial progress is understood as a primary

Responsibilities of...

Treasurer / Finance Committee member

- **Assess and mitigate risks**
- **Develop trustful scepticism**
- **Recruit a qualified treasurer**
- **Report outcomes effectively**

responsibility. It's also increasingly important to develop effective methods of reporting non-financial information. Program outcome information for internal and external groups, particularly funders and the Board will show the effectiveness and momentum of programs. These significant indicators indicate how well the mission is being fulfilled. Think of your own not-for-profit and how effectively the money you're using is achieving the mission of the organization.

Selection of the auditor

The auditor

- **Arms-length relationship requirements**
- **Experience with not-for-profits is key**

In the past, auditors were often key contributors to organizational planning. They helped prepare journal entries, developed policies and procedures and even wrote letters on behalf of their not-for-profit clients. This has changed because of situations like the Enron meltdown where the auditors, who were also acting as management consultants, were auditing the rather creative recommendations of their associates. New independence requirements prohibit the old, collegial relationship that used to exist between auditors and clients. This new, arm's length relationship can leave gaps for some not-for-profits that used to rely on their auditor's guidance.

Additionally, since accounting standards for not-for-profits are changing quite rapidly, not all accountants are well-versed in these changes. This can lead to trouble for small and medium-sized organizations that believe they're doing the right thing, but aren't aware of the new landscape. (See notes 3 and 4 that follow the Troubled Society case that identify current and future changes in accounting policy to get a sense of the extent of changes.)

Given this environment, it is critical to find an auditor who has a number of not-for-profit clients and who is up-to-date on the accounting issues facing the sector.

Options for reporting

Reporting options

Three levels:

1. **Audit**
2. **Review engagement**
3. **Notice to reader (Compilation)**

We tend to think of the annual audit as the only option for financial reporting. However, there are in fact three levels of reporting that your accountant can perform: an audit, a review engagement, or a notice to reader statement (also known as a compilation). Each has a different amount of scrutiny attached, and does a different amount of testing of the veracity of the statements. It is important to be undertaking the right kind of reporting to meet your own needs and the needs of audiences who read your statements, such as funders. A notice to reader, for example, has little of the scrutiny that is important at year-end and should not normally be

considered as a replacement for an audit or a review. It may, however, be acceptable for a very small organization with limited income and expense streams.

Due to the additional independence, reporting and other requirements associated with doing an audit these days, the cost has significantly increased. These changes, and additional costs, do not necessarily improve the value of the reporting to the client so some organizations are electing to have a review engagement done, rather than an audit, since the cost can be about half that of an audit. For the reduction in price however, there is a reduction in the rigour of the planning, examining, assessing, testing and other work done, so organizations must consider the impact of this reduced level of scrutiny. Some funders and some Boards will require an audit for the additional comfort it gives that all is well with their financial reports.

There will also be a difference in price between what a large or national auditing firm charges, and what you can expect in price from a small local shop. The audit standards will be the same – everyone uses the CICA guidelines – so it may be worth asking other not-for-profits of your size, or with your type of revenue streams, for a referral to their accountant or auditor. The following reports give an indication of the different type of work that is done for an audit engagement and a review engagement.

Example of an Auditor's Report

To the Members of

I have audited the statement of financial position of as at, 20... and the statements of operations, changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the organization's management. My responsibility is to express an opinion on these financial statements based on my audit.

Except as explained in the following paragraph, I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In common with many charitable organizations, the organization derives revenue from (specify type of contributions affected) the completeness of which is not susceptible of satisfactory audit verification. Accordingly, my verification of these revenues was limited to the amounts recorded in the records of the organization and I was not able to determine whether any adjustments might be necessary to contributions, excess of revenues over expenses, current assets and net assets.

In my opinion, except for the effect of adjustments, if any, which I might have determined to be necessary had I been able to satisfy myself concerning the completeness of the contributions referred to in the preceding paragraph, these financial statements present fairly, in all material respects, the financial position of the organization as at, 20... and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

City (signed).....

Date CHARTERED ACCOUNTANT

Example of a Review Engagement Report

To [person engaging the public accountant]

I have reviewed the balance sheet of Client as at [Date] and the statements of income, retained earnings and cash flows for the year then ended. My review was made in accordance with Canadian generally accepted standards for review engagements and, accordingly, consisted primarily of inquiry, analytical procedures and discussion related to information supplied to me by the society.

A review does not constitute an audit and, consequently, I do not express an audit opinion on these financial statements.

Based on my review, nothing has come to my attention that causes me to believe that these financial statements are not, in all material respects, in accordance with Canadian generally accepted accounting principles.

City (signed).....
Date CHARTERED ACCOUNTANT



4. Accounting best practices

What are generally accepted accounting principles and why do I need to understand them?

“Generally accepted accounting principles encompass broad principles and conventions of general application, as well as rules and procedures that determine accepted accounting practices at a particular time.”

Canadian Institute of Chartered Accountants (CICA) Handbook, Section 1100

Generally Accepted Accounting Principles (GAAP) is the set of best practices that accountants use to ensure an organization’s financial statements meet acceptable standards. These principles have developed over time and continue to develop and change as new practices are tried and proven. Interestingly, GAAP is not only somewhat fluid, but it comes from a variety of sources as diverse as findings from academic research studies to best practices in other countries.

Some of the GAAP practices are codified in the CICA Handbook, the publication that Canadian accountants and organizations must look to first for rules. If the CICA Handbook does not address a certain accounting policy, accountants follow something that is called the GAAP Hierarchy to find an accepted practice to apply to any particular situation they’re addressing.

GAAP is important for two reasons. First, it describes how all organizations should state their finances, so no organization is trying to come up with its own way of reporting its position. Second, since everyone follows

Accounting best practices

$$\begin{array}{r} \text{Generally} \\ \text{Accepted} \\ \text{Accounting} \\ \text{Principles} \\ + \\ \hline = \text{GAAP} \end{array}$$

the same principles, GAAP allows comparability, both year-to-year for an organization, and between different organizations. This comparability allows management, funders, members, government and other stakeholders to analyse how well their not-for-profit organization is doing compared to previous years and compared to other similar organizations.

GAAP principles

- **Regularity**
- **Consistency**
- **Sincerity**
- **Permanence of methods**
- **Non-compensation**
- **Prudence**
- **Continuity**
- **Periodicity**
- **Full disclosure / materiality**
- **Utmost good faith**

GAAP is based on a number of principles that appear below. You will likely recognize many:

- Principle of regularity: **conformity to enforced rules and laws**
- Principle of consistency: **enter all similar items in exactly the same way**
- Principle of sincerity: **reflect in good faith the reality of the financial status**
- Principle of the permanence of methods: **coherence and comparison information**
- Principle of non-compensation: **do not offset a debt with an asset, a revenue with an expense**
- Principle of prudence: **do not try to make things look prettier than they are. Typically, a revenue should be recorded only when it is certain and a provision should be entered for an expense which is probable.**
- Principle of continuity: **assume that the business will not be interrupted**
- Principle of periodicity: **transactions should be allocated to a given period, and split accordingly (if it covers several periods)**
- Principle of full disclosure/materiality: **all significant information must be disclosed in the records**
- Principle of utmost good faith: **all statements must be true and all material facts must be revealed**

Although all external, general purpose financial statements must follow GAAP and very specific structures, internal statements can be prepared on any base of accounting principles and can highlight what is important to management. That's why accountants will always refer to internal statements as "management statements". That said, it is in your interest as a member of the Finance Committee to ensure a close correlation between external and internal statements: it's more efficient and when everyone (externally and internally) is working with the same information, it instils greater confidence that the financial management is sound.

What GAAP principles should you pay closest attention to?

Since it's your job to oversee the finances of your organization – not to prepare financial statements and not to know the rules of accounting as intimately as your accountant or auditor – it's helpful to understand two particular accounting areas covered by GAAP.

Both of the following examples, 'cash versus accrual' and 'deferred versus restricted fund' accounting, deal with different timing on recognising revenues and expenses. An example will help you understand the impact of using these different accounting approaches.

Cash versus accrual method of accounting

There are two principle methods for keeping track of an organization's income and expenses: the cash method and the accrual method. GAAP requires the accrual method, however the cash method is reviewed here to provide a comparison and context for smaller organizations.

The major difference between the cash method and accrual method of accounting is in the timing of when you credit your account with income and debit expenses. Because the cash method doesn't provide an organization with a complete or accurate picture of its actual, current financial situation, the accrual method is more accurate. In organizations where the cash method is used on a daily basis, the accrual method should be used on a monthly, quarterly or at minimum, on an annual basis to accurately reflect any outstanding payables, receivables, or cash held in reserve for future projects.

What are the differences?

Cash method

Using the cash method, income and expenses are recorded on the books as the cash enters or leaves the bank account. For example, if you receive an invoice for services you have purchased, even if the service has already been provided, you would not record that expense in your accounting records until the cheque you've written to pay for the service has been cashed. And on the income side, the cash is counted only after it has been deposited in the bank.

Accrual method

Using the accrual method, the income and expenses are recorded in the period the transaction occurs. For example, when you receive a service, you record the cost of that service in your books as soon as the service has been provided, regardless of when the service-provider invoices you or cashes your cheque. And on the income side, money is counted as soon as

Key GAAP principles

1. **Cash vs accrual**
2. **Deferred vs restricted fund**

Cash vs Accrual

Cash

- **Income and expenses are recorded as cash enters or leaves bank account**

Accrual

- **Income and expenses are recorded when the transaction occurs**

the donation is received or sale revenue is earned; you don't wait until the money is deposited in your account to recognize the transactions.

For many small organizations, the burden of doing accrual method accounting on a daily or weekly basis outweighs the technical accuracy that it brings to the books. If you are a one- or two-person organization, or entirely volunteer-run, it may not make sense to spend time and money on accrual accounting. For very small organizations that need to buy accounting software, the financial savings of not buying accounting modules to deal with payables and receivables can be significant. For example, ACCPAC has a basic module which will let you do cash accounting; adding the payables and receivables modules can add thousands of dollars to the purchase price.

Many small and medium-sized organizations that write only a handful of cheques a month can manage quite well using the cash method on a daily basis, and reserve the "truing up" of accruals for a period end. This will work as long as the Executive Director keeps track of funds received for work not yet completed, and doesn't pre-spend or allocate those funds. However, at year-end, the accrual method must be used to create financial statements that accurately reflect the actual financial position of your organization, including outstanding payables and receivables that would not be reflected in cash accounting.

Recommended actions

1. Determine what method of accounting your bookkeeper or accountant is using on a month-to-month basis.
 2. If the cash method is used day to day, ensure that the books are "trued-up" to the accrual method either monthly or quarterly.
-

Deferral vs restricted fund

Deferral

- **Contributions are not counted until related expenses have been applied**

Restricted Fund

- **Contributions accounted for as they are received**

Deferral versus restricted fund accounting

Methods of accounting are a place where not-for-profit organizations differ from for-profit enterprises. Most not-for-profits use the deferral method; however, but in some cases, the restricted fund method is chosen to show results in a different way. There is a growing movement among social enterprises to use the restricted fund method, to align program costs with expenses, but the deferral method remains the more widely used approach. Both methods are described here and the results of using one over the other can be quite dramatic.

What are the differences?

Using the restricted fund accounting method, contributions are accounted for as they are received and applied to their particular restricted fund. Using the deferral method, the contribution is made to the restricted fund, for instance, but it is not counted on the books as revenue until the expenses related to that income are expended and can be applied against the contribution.

One of the challenges with using the deferral method of accounting is that your organization may find itself reporting income from funders quite differently from the grant they gave you. This can confuse funders who will know that they gave you a grant of \$10,000, when they only see \$3,975 recorded. One way to address this apparent discrepancy is to create a supplementary schedule that shows what the full grant is and how much of that grant is being deferred.

Case to compare deferral and restricted fund accounting

An example of how the deferral method of accounting creates a different statement than the restricted fund method follows. In this example, a grant of \$300,000 is received to cover three years of programming.

In this example, using the deferral method, income is recorded as it is received from the funder – \$30,000 in year one, \$210,000 in year two, \$60,000 in year three.

Under the restricted fund method the entire \$300,000 is applied in the first year and the surplus flows to the Fund Net Assets line, for use in future years. Note that this has the same general impact in the program fund as if the cash method of accounting was used.

Review the figures that follow to get a sense of how results can vary drastically.

How do you choose?

Deferral is most common

- **Simpler**
- **More transparent**
- **Easier to understand**
- **Better accepted**

Statement of Financial Position, Year 1

Deferral		Restricted Fund	
Cash	\$ 450,000	Cash	\$ 450,000
Accounts receivable	\$ 70,000	Accounts receivable	\$ 70,000
	\$ 520,000		\$ 520,000
Capital Assets	\$ 65,000	Capital Assets	\$ 65,000
	\$ 585,000		\$ 585,000
Accounts Payable	\$ 73,000	Accounts Payable	\$ 73,000
Deferred Revenue	\$ 270,000	Deferred Revenue	\$ -
	\$ 343,000		\$ 73,000
Net Assets		Net Assets	
Invested in capital assets	\$ 65,000	Invested in capital assets	\$ 65,000
Program fund	\$ -	Program fund	\$ 265,000
Net assets available	\$ 177,000	Net assets available	\$ 182,000
	\$ 242,000		\$ 512,000
	\$ 585,000		\$ 585,000

Statement of Operations, Year One

Deferral		Restricted Fund	General Fund	Program Fund
Revenues		Revenues		
Donations	\$ 140,000	Donations	\$ 140,000	\$ -
Grants	\$ 30,000	Grants	\$ -	\$ 300,000
	\$ 170,000		\$ 140,000	\$ 300,000
Expenses		Expenses		
Payroll	\$ 100,000	Payroll	\$ 100,000	
Office	\$ 25,000	Office	\$ 25,000	
Program delivery	\$ 35,000	Program delivery	\$ -	\$ 35,000
	\$ 160,000		\$ 125,000	\$ 35,000
Excess of revenue over expenses	\$ 10,000	Excess of revenue over expenses	\$ 15,000	\$ 265,000
Net assets available, beginning of year	\$ 167,000	Net assets available, beginning of year	\$ 167,000	\$ -
Net assets available, end of year	\$ 177,000	Net assets available, end of year	\$ 182,000	\$ 265,000
Reconciliation schedule for funders		(No reconciliation schedule required)		
Total grants received	\$ 300,000			
Portion deferred	\$ (270,000)			
Net grant revenue reported	\$ 30,000			

Statement of Financial Position, Year Two

Deferral		Restricted Fund	
Cash	\$ 275,000	Cash	\$ 275,000
Accounts receivable	\$ 70,000	Accounts receivable	\$ 70,000
	\$ 345,000		\$ 345,000
Capital Assets	\$ 65,000	Capital Assets	\$ 65,000
	\$ 410,000		\$ 410,000
Accounts Payable	\$ 73,000	Accounts Payable	\$ 73,000
Deferred Revenue	\$ 60,000	Deferred Revenue	\$ -
	\$ 133,000		\$ 73,000
Net Assets		Net Assets	
Invested in capital assets	\$ 65,000	Invested in capital assets	\$ 65,000
Program fund	\$ -	Program fund	\$ 75,000
Net assets available	\$ 212,000	Net assets available	\$ 197,000
	\$ 277,000		\$ 337,000
	\$ 410,000		\$ 410,000

Statement of Operations, Year Two

Deferral		Restricted Fund	General Fund	Program Fund
Revenues		Revenues		
Donations	\$ 140,000	Donations	\$ 140,000	\$ -
Grants	\$ 210,000	Grants	\$ -	\$ -
	\$ 350,000		\$ 140,000	\$ -
Expenses		Expenses		
Payroll	\$ 100,000	Payroll	\$ 100,000	
Office	\$ 25,000	Office	\$ 25,000	
Program delivery	\$ 190,000	Program delivery	\$ -	\$ 190,000
	\$ 315,000		\$ 125,000	\$ 190,000
Excess of revenue over expenses	\$ 35,000	Excess of revenue over expenses	\$ 15,000	\$ (190,000)
Net assets available, beginning of year	\$ 177,000	Net assets available, beginning of year	\$ 182,000	\$ 265,000
Net assets available, end of year	\$ 212,000	Net assets available, end of year	\$ 197,000	\$ 75,000
Reconciliation schedule for funders		(No reconciliation schedule required)		
Total grants received	\$ -			
Portion deferred	\$ 210,000			
Net grant revenue reported	\$ 210,000			

Statement of Financial Position, Year Three

Deferral		Restricted Fund	
Cash	\$ 210,000	Cash	\$ 210,000
Accounts receivable	\$ 70,000	Accounts receivable	\$ 70,000
	\$ 280,000		\$ 280,000
Capital Assets	\$ 65,000	Capital Assets	\$ 65,000
	\$ 345,000		\$ 345,000
Accounts Payable	\$ 73,000	Accounts Payable	\$ 73,000
Deferred Revenue	\$ -	Deferred Revenue	\$ -
	\$ 73,000		\$ 73,000
Net Assets		Net Assets	
Invested in capital assets	\$ 65,000	Invested in capital assets	\$ 65,000
Program fund	\$ -	Program fund	\$ -
Net assets available	\$ 207,000	Net assets available	\$ 207,000
	\$ 272,000		\$ 272,000
	\$ 345,000		\$ 345,000

Statement of Operations, Year Three

Deferral		Restricted Fund	General Fund	Program Fund
Revenues		Revenues		
Donations	\$ 140,000	Donations	\$ 140,000	\$ -
Grants	\$ 60,000	Grants	\$ -	\$ -
	\$ 200,000		\$ 140,000	\$ -
Expenses		Expenses		
Payroll	\$ 100,000	Payroll	\$ 100,000	
Office	\$ 25,000	Office	\$ 25,000	
Program delivery	\$ 80,000	Program delivery	\$ -	\$ 80,000
	\$ 205,000		\$ 125,000	\$ 80,000
Excess of revenue over expenses	\$ (5,000)	Excess of revenue over expenses	\$ 15,000	\$ (80,000)
		Interfund Transfer	\$ (5,000)	\$ 5,000
Net assets available, beginning of year	\$ 212,000	Net assets available, beginning of year	\$ 197,000	\$ 75,000
Net assets available, end of year	\$ 207,000	Net assets available, end of year	\$ 207,000	\$ 0
Reconciliation schedule for funders		(No reconciliation schedule required)		
Total grants received	\$ -			
Portion deferred	\$ 60,000			
Net grant revenue reported	\$ 60,000			

Accounting management

Employing an accountant on payroll, working on-site, has many benefits, including having an accountant's expertise to contribute to strategic and budget planning exercises, and having someone keeping an eye on ways to streamline accounting processes and improve efficiencies in operations. But this option can be costly, and impractical for small organizations.

When having a staff accountant is not feasible, out-sourcing higher-level accounting management has benefits: it can lower accounting costs, improve the productivity of staff bookkeepers and allow key staff to focus on core competencies, as opposed to trying to be a Jack- or Jacqueline-of-all-trades.

There is no right or wrong approach to accounting management: the right solution depends on the size of the organization, the complexity of the revenue streams, and project reporting requirements.

Accounting management

- **Accounting department or accountant**
- **Contract or "out-source"**

Consider

- **Organization's size**
- **Complexity of revenue streams**
- **Project reporting requirements**

Recommended actions

1. To determine if your not-for-profit has the best solution to your financial management needs, consider and evaluate the following questions:
 - a. Does your current solution cover both the straightforward payment of bills and reconciliation of bank accounts?
 - b. Are you getting timely and accurate financial information, particularly in the areas of variance analysis and budgets?
 - c. Are you maintaining good financial controls and are you informed about problems in advance?
 - d. Would your organization be better served by having a bookkeeping person doing the work of approved bill payment and receipt tracking and someone else doing financial management?

Tools for managing books

It's important to get good advice from an accountant who understands your organization's needs before investing in accounting software. You don't want to buy more than you need, but you should invest in a system that is robust enough to support growth.

While accounting software is easily used and understood by accountants, one of the challenges of many programs is the general inadequacy of the reporting function for management review purposes: creating reports that can be read and understood by the Executive Director, Treasurer and other Board members is often difficult.

Tools for managing books

- **No single solution**
- **Prepare a needs assessment**
- **Ensure staff are trained**
- **Talk to similar-sized organizations**

If your organization is involved in fund development/fundraising, another consideration is how your accounting software integrates member, donor and pledge tracking. CRM, or “customer/client relationship management,” is a critical component of member and donor stewardship, but is often not well-tracked. When considering accounting software, ask how it links with any CRM tools you may be using, or may be considering. Ask other organizations of your size and with similar revenue and project structures what software they use, and how well it’s meeting their needs.

Recommended actions

1. The following questions can help you make an informed purchasing decision about accounting software:
 - a. Have you prepared a needs assessment on your systems based on feedback from users of the information, including staff and Board? Think in terms of what the different members of the Finance Committee will need, as well as how the software serves different staff functions.
 - b. Does your accounting staff understand the capabilities of the software they are currently using – have they been to training or called the help desk to learn more?
 - c. Has someone from your team talked with other similar-sized organizations to compare challenges and software?
-

General ledger and audit trails

General ledger and audit trails

Audit trails

- **Record of events made in general ledger**
- **Tells why revenues and expenses were received or incurred**

Audit trails are simply the record of events made in your general ledger over the year.

It’s important that all events, including changes to correct errors or make adjustments, are recorded and are transparent. At year-end, an auditor or accountant will need to see the documentation that supports entries made in the general ledger. From paper copies of receipts to bank deposit slips to reversals of entries and corrections in accounting software: all of these actions leave a trail that tells a story of why revenues were received and expenses were incurred. The audit trail explains why changes have been made to the general ledger, and as long as there is clear documentation, no one is likely to question transactions or corrections.

Recommended actions

It’s normally sufficient for the Treasurer and other Finance Committee members to rely on your accountant to monitor and correct entries and to have your auditor do the annual review and provide a report to the Audit Committee. However if your organization is facing any kind of financial

questions or unresolved issues, it would be good practice to undertake the following actions:

1. If during the financial review process there are recurring questions about figures and explanations are slow in coming – spend some time reviewing account transactions.
 2. If you want to become better informed on what is going on behind the numbers – review and discuss the bank reconciliation and accounts receivable/ payable and payroll processing with your accountant/bookkeeper.
-

Internal controls

Everyone involved in your organization has a role to play in monitoring internal controls, from junior staff to senior management to the Board of Directors. As a member of the Finance Committee, you play a leadership role in this area.

While not obvious to most not-for-profit staff or volunteer Board members, the risk of fraud can be high in not-for-profits because of the trusting nature of the sector. Indeed, while many organizations have excellent procedures, some have non-existent or ineffective internal controls. It's an area to which staff does not typically give a lot of thought, as it may run contrary to the general operating climate. Given the combined atmosphere of trust in most not-for-profits, cash donations and often, limited business or financial expertise among staff, having clear financial controls is critical.

Internal financial controls are used to promote and protect sound financial management and are vital in protecting your organization's assets, reputation and integrity. They ensure the reliability of the financial information produced about your not-for-profit and mitigate (as much as possible) against the chance of your organization's assets being stolen or misused. Financial controls also ensure that policies are followed and that government regulations are met.

Simply put, controls are the checks and balances that are followed by all staff. The main objectives of internal financial controls in any organization include safeguarding assets, promoting efficiency in operations, enhancing the reliability and completeness of financial reporting and minimizing the risk of misuse or abuse of the organization's resources. The more checks and balances your organization has, the fewer opportunities there are for fraud to occur.

Internal controls

- **Used to promote and protect sound financial management**
- **Protect organization's assets, reputation, integrity**
- **Ensure reliability of information**
- **Mitigate risk**

Everyone has a role to play.

Good financial controls include:

- Authorization for transactions
- Completeness and accuracy of financial information
- Physical safeguarding of assets
- Segregation of duties

Example of Fraud: The Phantom Supplier Fraud

Many organizations have been victimized by the Phantom Supplier Fraud. One not-for-profit was defrauded by its own accounts payable/ purchasing manager in a scam involving the supposed purchase of stationery supplies. In this particular case, other employees became suspicious about the stationery supplier. The employees recognized several oddities about this particular supplier including:

- Never having seen a salesperson, catalogue or price list
- Invoices that lacked a full address, except for a post office box
- All invoices were for amounts under \$500, which under the not-for-profit's policy ruled out the need for additional quotations
- No cheque issued to this supplier ever exceeded \$1,000. This cap meant that the cheques could be processed through a cheque-signing machine under the accounts payable/ purchasing manager's direct control rather than requiring two Board members to sign the cheques.
- The cheques were never mailed to this supplier but were always hand-delivered by the manager.

The employees reported their concerns to the accounts payable/ purchasing manager, but no action was taken. They eventually reported their suspicions to the Treasurer who launched an investigation. The investigation revealed that no stationery had ever been provided by this supplier, and that it was merely a vehicle set up by the accounts payable/ purchasing manager to defraud their employer.

All the financial controls in the world won't prevent errors, omissions or fraud, so be aware of certain limitations, including:

- Reliance on the judgment of management and employees.
- The possibility that management may override otherwise effective controls.
- The possibility of collusion between employees to circumvent the internal control system.
-

Recommended actions

1. Review last year's management letter from the auditor, to identify any potential gaps in security identified through the audit.
2. Ask your staff leadership to confirm the policies and practices in place to authorize payments, transfer funds, make investments, etc.
3. Ensure your staff leadership is actively monitoring financial transac-

tions and is reporting to the Board.

4. Annually, choose one area on which to focus and ask the Executive Director to produce the policies that set out the controls, and to run a practice test of those controls internally. For example, if there is a policy that the mail is opened by two staff during the annual appeal (when cash donations might be received), ask the Executive Director to monitor the mail opening for a day or two and report back to the Board.

Following the recommendations in the sections Developing a cash flow projection and Creating what-if scenarios will also support efforts to ensure financial controls are being observed and followed by all staff.

Segregation of duties

The above-mentioned fraud happened because of a breakdown in the fundamental internal control related to segregation of duties. The best practice is to segregate the purchasing function from the payables function. This, of course, can be particularly difficult in small organizations where limited staff numbers may require one person to perform two or more incompatible functions. This situation, however, does provide an ideal opportunity for this one person to defraud the organization. It is important to remember that fraud often occurs at levels just below an employee's transaction authority level. In the Phantom Supplier Fraud case, the dishonest employee was careful to keep the individual invoices under \$500 and the cheques under \$1,000 to avoid scrutiny.

Lack of segregation of duties is also often a problem on the cash-handling side. Consider the case of a not-for-profit that had a volunteer organize fundraising events in conjunction with an association that sponsored such events. At the end of each fundraiser, the volunteer and an association representative agreed on the revenues earned during the event and signed a report that indicated this amount. The volunteer then deposited the funds raised into the not-for-profit's bank account and submitted a copy of the event report to the accounting office. The volunteer, however, was not depositing all of the funds raised. Rather, he provided a 'doctored' version of the event report to his accounting staff that exactly matched the money that he deposited into the not-for-profit's bank account.

Eventually, the not-for-profit's accounting personnel became suspicious when they learned through conversations with other not-for-profits that the amount of money raised through similar fundraisers was greater than in their events. When they asked to see the event reports filed with the fundraising association and matched them against the reports provided by their own volunteer, they discovered the fraud.

Good financial controls

- **Assign authority effectively**
- **Ensure reports are complete and accurate**
- **Safeguard assets**
- **Segregate duties**

Authority and authority leaks

Most not-for-profits have rules set out by their Boards in the form of a Board resolution, about delegation of authority for who can sign cheques and who can enter agreements and contracts for the organization.

Day-to-day, the rules are sometimes ignored or forgotten in the interest of expediency or because the delegated authorities simply don't understand the rules. There are a number of practices that can be developed as accounting policies to ensure rules are not overlooked.

What policies should be in place?

Signing authority on cheques

It is a common belief that financial institutions check that the signatures on cheques match the signature cards on file at the institution. This is simply not true. Banks and credit unions do not have the time to review each cheque against a signature card on file. Not-for-profits should establish clear rules about who signs cheques, at what amounts, and stick to those protocols. The accountant or bookkeeping staff should monitor adherence to these rules.

Many not-for-profits set up their bank accounts to require two signatures on cheques, if not on all amounts, on amounts above a certain cash value. It is common practice to have one of the two signatures be either the Executive Director or another person in senior management and a Board member, most often, the Treasurer.

There is an unfortunate common practice among not-for-profits where one of the signing authorities signs blank cheques in order to "speed up payment process." In order for this important control to be effective, it is important that both signing officers only sign completed cheques that are presented along with supporting documentation.

Transfer authority at the financial institution

Another area where not-for-profits frequently, and inadvertently, run afoul of Board resolutions about signing authorities is with daily transactions at the bank or credit union. If a not-for-profit requires two signatures on a cheque, it is implied that two signatures are required on any kind of external banking transaction. Therefore, the bookkeeping staff should not be able to transfer funds out of the bank account to a service provider via on-line banking, for instance, without a second signature or action by another signer. Likewise, the bookkeeping staff should not be allowed to initiate wire transfers without supporting documentation signed by two authorized signers.

Recommended actions

1. Review your organization's cheque-signing and transfer authority policies.
 2. Do a spot check of all cheques that were signed and transfers that were initiated in the last three to six months (depending on the quantity) to determine if your policy is being followed.
 3. If the policy is being followed 100% of the time, acknowledge staff and Board for their diligence.
 4. If the policy is not being followed 100% of the time, address the authority leak.
 5. If you determine that your policy is not adequate to protect the best interest of the not-for-profit, write a new policy for discussion and adaptation by the Board.
-

Contract authority on leases and contracts

In the same way that Boards may delegate certain cheque signing authorities to staff, the Board may delegate signing authority to staff on leases and contracts. Careful attention should be paid to long-term contracts. Photocopier leases are a good example of where mistakes can happen. An Executive Director may have the authority to sign contracts up to \$10,000 and so enters into and signs a five-year contract for a photocopier lease, with a monthly payment of \$600. The contract they have signed, however, has a "lifetime value" of \$36,000 (\$600 x 12 months x 5 years). The Board is ultimately responsible for this level of obligation and should have authorized and signed this lease agreement.

Recommended actions

1. Review your organization's policy on contract authority on leases and contracts.
 2. Review all active contracts and commitments to determine if your policy is being followed.
 3. If the policy is being followed 100% of the time, acknowledge staff and Board for their diligence.
 4. If the policy is not being followed 100% of the time, address the authority leak.
 5. If you determine that your policy is not adequate to protect the best interest of the not-for-profit, write a new policy for discussion and adaptation by the Board.
-

Investment issues

The management of investments is almost always the responsibility of the Finance Committee, from setting investment policies, to reviewing

investment options and making recommendations for action to the Board. Even if your organization does not have large amounts of cash available for long-term investment, it is important to have an investment policy that addresses, for instance, how to handle a large grant or contract income. Imagine your organization were to receive a lump-sum grant of \$100,000 to be disbursed over two years. Developing an investment policy will answer whether you should hold that money in a low interest savings/chequing account, or put a portion into a short-term investment vehicle that earns better interest.

When reviewing (or developing) an investment policy for your organization, keep two things in mind:

1. You will be required to either follow the policy you create or amend it every time you make a decision that falls outside the rules you've established. This caution is simply to advise that writing an investment policy in broad terms is easier than creating one that is highly specific (such as mentioning specific investment options that may not always be available). It's important to pay special attention to how your investment policy may impact special funds that you either have or hope to receive one day, such as 'donor-restricted' and 'Board-restricted' funds.
2. It is also important to be aware of the Prudent Investor Rule (known in legal circles as the Uniform Trustee Investment Act). This rule relates to the Duty of Care (see Legal Limberness for more information about this subject) as related to investments. In a nutshell, the Prudent Investor Rule a) requires diversification as a duty for prudent investing, b) does not allow speculation and outright risk-taking with investments, and c) establishes that the investment management may be delegated to a third party.

Solid investment policies follow a certain structure and include standard considerations. That said, your investment policy will be unique to your organization, so simply copying the policy of another organization is not recommended.

Recommended actions

1. If your organization does not have an investment policy, begin the discussion at the Finance Committee level, to create one even if at this point in time you don't see a pressing need for one. Your banker or investment advisor should be able to provide a template for information.
2. If your organization has an investment policy, have the full Finance Committee review it to ensure that it is both relevant to your current situation and is being followed. Consider having your banker or investment advisor provide input and comment on the

- policy.
3. If you feel that your investment policy is too restrictive or does not make sense given your organization's current situation, bring in an expert to guide you in the development of a new policy.
-

Keeping your organization out of hot water

A range of actions have been described that will help to keep your not-for-profit out of hot water. The following true stories are specific situations that have happened over the last few years and that might have been avoided had appropriate procedures been in place. The question to ask yourself when reading these stories is, "How well is our organization protected from these situations?"

Understanding your net assets

It's important to have a solid overview of the financial strength of your organization and know where that strength comes from. Consider the two following examples.

Case study one

A social service agency had a sudden reduction in funding which resulted in the forecasting of a significant cash shortfall. The Board and staff were quickly called together and decisions were made to significantly reduce programming to achieve a bottom line balance at the end of the year. Many clients were inconvenienced and some were put at risk by the withdrawal of services on short notice. The trust in the organization and their position in the community was negatively impacted.

At year-end, the budget was balanced and the Board congratulated themselves – until they realized that the organization had significant unrestricted net assets which could have been used to cover the shortfall and to act as a stopgap until funding could be replaced.

Lesson: Understand the long-term financial strengths of the organization so that short-term challenges can be met appropriately.

Case study two

The management of a not-for-profit was keen to support clients and to put as many resources into programming as possible. To this end, they supported their funder's request to increase programming staff hours without an increase in funding. Over a four year period, the Finance Committee found that the budget was balanced, but that the budget required more donation income to achieve this balance. Ultimately, donation revenue was not adequate to meet the cost of delivering the programming and the trend of the year-end bottom line changed from a small surplus to a significant and increasing deficit.

Case studies

- **Understanding net assets**
- **Budgets and planning**
- **Cash management and review of reconciliations**
- **Gift acceptance/designation policy**

A review of their largest program found that management, in negotiations with their funder, had moved one full-time equivalent (FTE) staff person from program administration to a counselling position and had reduced supervision time by .5 FTE. Additionally, the administration component of the contract had not increased with the cost of living. These changes meant that the cost of administering the program was no longer being funded by the funder but rather by donations.

There was a happy ending. The contract was reviewed with the funder and rebalanced to provide appropriate administration funding.

Lesson: It is critical to cover the cost of administration to achieve sustainability. (The Cashflow Calisthenics handbook covers this subject in greater detail).

Budgets and planning

Following are two eye-opening stories about what can go wrong when planning is not done and budgets are not developed.

Case study three

A local, animal care charity was having difficulty balancing their budget so they looked at the payback of their fundraising staff. In their review, they determined that planned giving normally provides a return on expenditure in five or more years – that the bequest that donors leave in their will is received some time in the future. To reduce expenses, this organization reduced their planned giving staff.

During a subsequent strategic planning review that involved looking at five years of historical data, they realised that much of the growth in revenues had been in the planned giving area and that this represented a significant area of opportunity. They re-allocated additional staff to the area and now, five years on, are receiving a steady flow of significant bequests which are allowing them to expand services.

Lesson: Longer term planning using historical information to inform future decisions is an important way to identify both strengths and weaknesses and to provide context for short-term decisions.

Case study four

A local charity discovered that the senior staff person, who was also involved with payroll, had been cutting herself two salary cheques each pay period and having two separate directors sign them at different times. This fraud had been going on for over a year.

As part of the budget process, a salary budget should have been developed based on the number of employees on payroll and this should have been

reviewed by both staff and Board for reasonability. For most organizations, the salary cost is 70% to 85% of total expenses, so this is the largest and most important of the budget lines. If the budget had been developed and reviewed with some precision and if variance to budget information was available on a regular basis, the variances to budget analysis would have shown the overspending and a summary review would have disclosed this theft.

Lesson: Staffing is the largest budget line. Ensuring that accurate information is developed will help with monitoring spending and reduce the likelihood of staff being tempted to steal.

Cash management and periodic review of reconciliations

It is very important to have good controls over cash, payroll and bank accounts. This situation is described above in the phantom supplier case study, and in the following stories.

Case study five

A church acquired significant funds selling buildings. The result was that they had substantial cash and investments on-hand that were not regularly monitored. The church Finance Committee was not in the habit of reviewing the bookkeeper's transactions and since the Treasurer was often out of town, he pre-signed a number of cheques which he reviewed when he returned.

The temptation was too much for the bookkeeper who cashed pre-signed cheques for his own use. The money stolen was never retrieved.

Lesson: Establish strict controls and follow them. Period.

Case study six

A bookkeeper responsible for bank reconciliations removed some cash from a deposit and covered the shortage with cheques. When the amount reached a size that could not be covered by cheques on-hand, she put the outstanding amount as a reconciling item on the bank reconciliation. As there was no review of the bank reconciliation, it was not discovered until year-end.

Lesson: Ensure that someone reviews and signs off on important reconciliations each month.

Case studies seven, eight and nine

A payroll clerk added hours to his pay as part of the payroll run. Since the payroll was never reviewed, he then added a fictitious employee to the run and cashed the cheque himself.

A major, national charity lost over a million dollars to a payables clerk working in their construction payables area. The organization had a number of large construction projects going and the clerk falsified invoices and forged approvals over a two-year period. It was only discovered when the clerk came forward.

An Executive Director made purchases on a credit card which were reviewed and processed by the accountant. Invoices were signed by appropriate people, however few details of the expenses were provided. The auditors discovered that many of the expenses were for personal purposes and that the accountant never questioned the boss's allocation of expenses. Fortunately there was an expense policy in place and the Executive Director was terminated.

Lesson: Signing authority and reconciliation review is critical in all organizations. An important Board and management responsibility is to put procedures in place that will reduce temptation. Cash control systems are an important part of that.

Case study ten

A charity assigned its Human Resources Director and the Board Chair to review the Executive Director's salary and performance. The HR Director reviewed salary trends in the sector and made recommendations, which were approved by the Chair and no one else. On review it was discovered that the HR Director had used performance indicators from a different sector and that the salary was significantly inflated. Both the Executive Director and the HR Director were terminated.

Lesson: Even if there are no questions, it is prudent to find an outside expert to provide an opinion on senior staff compensation.

Gift acceptance policy / designations policy

It can be useful to identify gifts that can be received in the normal course of business and those that need higher level approval or refusal. The following three stories offer a good reason to have policies in place around gifts.

Case studies eleven, twelve and thirteen

An environmental group was given some land which they accepted with the intention of selling it. Only after it was transferred to their books did they find that there was severe pollution which needed to be rectified at a cost that was greater than the value of the land.

A province-wide, health-related charity received a bequest to be spent on a relatively uncommon illness in a remote geographic area. After a number of years, the organization had to go back to relatives of the donor to ask permission to change the use of the funds.

A cancer-related charity was offered corporate sponsorship by a subsidiary of a tobacco company.

Lesson: Having policies in place to monitor the source and any restrictions on gifts can identify areas of possible difficulty.

Recommended actions

Consider implementing the following controls. This is particularly important for smaller organizations that have limited opportunity to segregate duties:

Bank controls

1. Have the Executive Director or Treasurer review and sign each bank reconciliation in a timely manner.
2. Consider having the Executive Director or Treasurer review both bank statements and returned cheques before giving these to the bookkeeper or accountant.
3. Restrict the ability of employees to move funds through different bank accounts.
4. Restrict the transfer of funds on investments outside the organization.
5. Require two signatures on each cheque and never pre-sign cheques.

Payroll controls

1. If the Executive Director is responsible for producing payroll cheques, have the Treasurer review and sign each payroll run, if possible, before cheques are written. If a bookkeeper or accountant writes or produces cheques, have either the Executive Director or Treasurer review and sign the payroll run.

Payable controls

1. Require that every invoice be initialled for approval by the individual who has budget responsibility for the expense.
2. Request that cheque-signers ask questions about unusual or large invoices.
3. Circulate financial information that includes variances to program staff on a regular basis and encourage staff to review transaction listings and ask questions if they have any.
4. Ensure there is an expense account policy in place and consider having the Treasurer personally review all of the Executive Director's expense accounts on a quarterly basis.

Personnel policies and procedures

1. Put personnel policies in place to eliminate the opportunity for misunderstanding -- include things like hiring, performance monitoring and discipline, contract relationships, hours of work, payment for overtime, holiday, benefits etc.

Gift acceptance policy / designations policy

1. Develop a gift acceptance policy to identify gifts that can be received in the normal course of business and those that will need a higher level of approval (or refusal). A gift acceptance policy will also ensure that gifts and large donations are made in accordance with legal and ethical regulations and guidelines. (See Legal Limberness for information about how Anti-terrorist Legislation affects not-for-profit gifts.)

Recommendations

- **Bank controls**
- **Payroll controls**
- **Payable controls**
- **Personnel policies and procedures**
- **Gift acceptance / designations policy**

Changes to accounting best practices for not-for-profit organizations

On January 1, 2011, Canada made using International Financial Reporting Standards (IFRS) a requirement for all publically accountable, profit-oriented enterprises. The impact on not-for-profits is that organizations now have a choice to report using either Part I of the Accounting Handbook published by the Canadian Institute of Chartered Accountants (known as the 'CICA Handbook') or Parts II and III of the same handbook.

Part I covers International Financial Reporting Standards. Electing to use Part I does not usually deliver enough benefit for the extra costs and resources required for the average not-for-profit due to the high cost to initially adopt these standards, keep abreast of changes to them, and to have them audited each year.

Part II addresses accounting standards for private enterprises and is referred to when issues are not covered in Part III.

Part III outlines accounting standards for not-for-profit organizations. Part III contains the specific accounting standards that pertain to private sector not-for-profits. The definition of a not-for-profit has not changed.

According to the CICA Handbook, "A NFPO is an entity, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. An NFPO's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization."

For the majority of issues, Part III of the new CICA Handbook covers what was previously contained in Part V of the last edition of the CICA Handbook, which many not-for-profits should be familiar with.

Note that government-controlled not-for-profits follow a different financial reporting framework, the Public Sector Accounting Standards, which are found in the PSA Handbook.

The new standards are still being debated in the accounting world. The 'Improvements to Not-for-Profits Standards Statement of Principles' is open to discussion and commentary until December 15, 2013. This means that while there is a set of standards, they are in flux, and will continually be updated and changed to meet the complex needs of financial information users.

As with IFRSs, there is a significant shift away from prescriptive rules to an emphasis on relying on the professional accountant's judgment.

The major changes do not affect most not-for-profits, but are in the following areas:

1. Measurement simplification:
 - a. Financial instruments (can be measured at fair market value - this is usually the one that affects not-for-profit organizations).
 - b. Asset retirement obligations
 - c. Employee future benefits
 - d. Goodwill and intangible assets

2. Disclosure requirements:
 - a. Reduction in the number of specific disclosure requirements to increase the value of disclosure and reduce the cost of disclosure.

For more information on current accounting standards for not-for-profit organizations in Canada, download:

[http://www.cica.ca/focus-on-practice-areas/small-and-medium-practices-\(smp\)/implementing-the-accounting-standards/item69429.pdf](http://www.cica.ca/focus-on-practice-areas/small-and-medium-practices-(smp)/implementing-the-accounting-standards/item69429.pdf)





5. Financial statements

Importance of quality, timely and reliable financial statements

In a well-functioning not-for-profit organization, financial statements are used for decision-making purposes, so the more accurate and timely they are, the more useful they are for making staff forecasting decisions, and for anticipating when it would be prudent to approach a financial partner (bank or credit union) to seek a line of credit or an operating loan.

Additionally, different individuals in the organization require different information to make decisions related to their work. The information required, while presented in the financial statements, may need to be manipulated into reports for different presentation purposes, and different decision-making.

- The management team needs detailed reports with a focus on each department so they can make precise decisions that may affect only one part of the organization.
- The Board of Directors needs a summarized, overall viewpoint of where the organization is, highlighting the different project departments as well as areas where there are issues that should be reviewed and addressed.
- Program partners need specific information on the project they're supporting and general information about the financial health of the whole organization. Typically, partners like to see something akin to the financial statement that would be prepared for management on the program they are partnered on and the summary that the Board uses to evaluate the financial situation of rest of the organization.
- Stakeholders, such as donors and service recipients or providers, are interested in a summary document such as that provided to the Board of Directors. Often, this group will also want to see some commentary about how the organization is doing in comparison to its goals and objectives.

Financial statements

Used for

- **Decision-making**
- **Forecasting**
- **Anticipating needs**

Different people need different information related to their role.

As a member of the Finance Committee – whether you're on staff or a Board member – it's important for you to understand the role of each financial statement your bookkeeping and/or accounting department prepares, know which statements to share with each interested party (noted above) and how to overlay those statements with any additional or different reports, and how to be able to read and interpret each statement.

Statement of financial position or Balance Sheet

- **Snapshot of assets and liabilities as of a particular day**

Statement of Financial Position

The Statement of Financial Position, often called the Balance Sheet, is simply a snapshot of your organization's assets and liabilities as of a particular day.

What should you look for?

Most assets are valued at fair market value with the significant exception of fixed assets that are valued at historical cost, less amortisation over their useful life. Investments are valued at market value for year-end valuation.

Both assets and liabilities must be segregated between current and non-current. Current assets are those assets that will be received within one year. Current liabilities represent obligations that are due within a year.

The recording of assets and liabilities in not-for-profit organizations is handled quite differently from the way they are recorded in for-profit enterprises. In a private company, the difference between the assets and liabilities is called 'retained earnings,' while in not-for-profits this difference is called 'net assets.' Net assets are calculated differently than retained earnings, using different categories to reflect the restrictions placed on the assets.

Those restrictions can be broadly categorized as follows:

- Invested in capital assets – these assets are locked up and not available unless the capital asset is sold. Commonly, these assets are only sold when an organization is winding up, or if the asset is being replaced with a new version.
- Externally restricted – these are assets that can only be used for specific purposes (like an endowment fund to support the activities of one project).
- Internally restricted – these assets are set aside for a specific purpose by Board resolution, which the Board can change if they desire.
- Available – these assets are considered “free and clear” money.

Following the general definitions and characteristics of each kind of financial statement you'll be expected to read and understand, The Troubled Society is a case study that highlights many of the areas where special attention should be paid when reading your not-for-profit's financial statements.

Statement of Changes in Net Assets

The Statement of Changes in Net Assets shows a Board where money went over the course of the year, and is a helpful tool for year-to-year comparisons. The most interesting aspect of a Statement of Changes in Net Assets for Board and management is the comparison between the opening and closing balance in each net asset category. The Statement of Changes in Net Assets may be presented on a separate statement, or the information may be combined with the Statement of Operations.

What should you look for?

The available net asset amount plus the internally restricted amount combine to give perhaps the most important number in the financial statement. They represent accumulated “reserves” of the not-for-profit and provide an indication of what the organization has accumulated over the years that can be used to cover shortfalls, subject to any ongoing restriction of the internally restricted amount.

When considering the sustainability of the organization, this number is critical. Many not-for-profits calculate the number of weeks of expenses that could be covered by this number, to give a sense of the robustness of the financial position.

Statement of Operations

A Statement of Operations is a summary of revenues and expenses for a particular period, usually a year, but it could be the period of a quarter year or even a month. The Statement of Operations for a not-for-profit looks similar to what is created for a private company and shows the financial results for the period.

A Statement of Operations must be reported on a gross basis. To a not-for-profit this means that if an organization held a fundraising event and raised \$100,000, with expenses of \$25,000, the Statement of Operations would have to show both the gross revenue and the expenses, not just the net of \$75,000.

What should you look for?

The heartbeat of the organization, this statement provides readers with progress on a year-to-date basis on how the organization is doing. When compared to a year-to-date budget with a variance amount and percentage, it allows staff and Board to assess whether they are achieving goals and objectives. There will always be variances due to changes in activity and the timing of transactions, however as a part of the review, staff should develop explanations on why variances are present and, if appropriate, recommend corrective action.

Of course the bottom line is critical. While there can be planned losses to cover short-term situations, losses over a longer period of time are rarely sustainable. As one worldly Treasurer put it: no money – no mission.

Statement of Changes in Net Assets

- Shows where money went over the year

Statement of Operations

- Summary of revenues and expenses for a particular period

Statement of Cash Flows

- **Shows source and use of cash in the organization**

Statement of Cash Flows

The Statement of Cash Flows shows the source and use of cash in the organization. It only records cash transactions. Your Statement of Cash Flows can be prepared on a direct or indirect basis. Almost all not-for-profit organizations use indirect basis since it's easier to prepare. This provides little more than a reconciliation of bank statements; it doesn't provide any new information. The reason it must be prepared is because it is a GAAP requirement. One element that is of value to review, is the subtotals in the three subsections: operating activities, investing activities and financing activities.

The statement of Cash Flows is only fascinating to people who love accounting but is not particularly useful for day-to-day operations.

What should you look for?

It can be interesting to see how the balance sheet areas are changing – for instance, the magnitude of change in cash, bank loans or payables as there may be trends that can be identified.

Notes and disclosures

- **Ensure readers have a complete picture of the financial standing**

Notes to financial statements (also known as notes and disclosures)

Notes and disclosures are required by GAAP to ensure that the readers of a financial statement have a complete picture of the financial standing of the organization. As such, they form an important part of financial statements.

Basically, notes and disclosures help you understand the story behind the numbers, and if there is anything unusual or important to understand about the numbers. It is not uncommon to find the most important information in the notes and disclosures because these provide more clarity to the numbers and more details on items where there is no numerical disclosure.

Notes will cover off issues like the accounting policies and practices used, and give the details behind the more general numbers that are in the statements. They will identify any significant changes in operations and disclose pending events which may not yet have had an impact on the financial position of the organization.

What should you look for?

Notes provide an important part of the information contained in the financials and should be developed and read with care. Note disclosure requirements are increasing each year. As they change, your auditor will be able to help you craft an appropriate disclosure and explain the reasons for the disclosure.



Troubled Society Financial Statements

Look for numbers [1] to [34] on the financial statements. Each has an associated comment.

To the Directors of Troubled Society

We have audited the Statement of Financial Position of Troubled Society as at March 31, 2013 and the Statements Changes in Net Assets, Operations and Cash Flows for the year then ended. These financial statements are the responsibility of the Society's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

Revenue and expenses for the employment program have not been subject to complete verification by audit procedures as we were not afforded the records to the program. Accordingly, we were not able to determine whether adjustments might be necessary to revenues, expenses and deficiency of revenue over expenses and net assets. [2] In common with many charitable organizations, the Society derives revenue from donations, the completeness of which is not susceptible to satisfactory audit verification. [3]

The accompanying financial statements, in our opinion, do not draw attention explicitly to doubts concerning the Society's ability to discharge its liabilities in the normal course of business. These doubts arise because it is uncertain whether the Society will be able to refinance the bank loan in the amount of \$150,000 due on November 9th, 2013 and in view of the existence of recurring operating losses in the past five years and the deficiency in unrestricted Net Assets of \$183,000. If refinancing cannot be arranged, it is not known whether the Society can continue as a going concern. [4]

In our opinion, except for the effect of adjustments, if any, which we might have determined to be necessary had we been able to satisfy ourselves concerning the completeness of the revenue and expenses referred to in the third paragraph and the going concern issue referred to in the fourth paragraph, these financial statements present fairly, in all material respects, the financial position of the Society as at March 31, 2013 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Chartered Accountants

Vancouver, British Columbia
May 22, 2013

**Troubled Society
Statement of Financial Position**

For the year ended March 31, 2013

2013

2012

Assets

Current

Cash and shortterm deposits (Note 7) [5]	\$	5,000	\$	20,000
Accounts receivable		20,000		10,000
Prepaid rent		2,000		2,000
		27,000		32,000

Capital assets (Note 8)

		950		-
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	\$	27,950	\$	32,000
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Liabilities

Current

Accounts payable and accrued liabilities [6]	\$	50,000	\$	7,000
Loan payable (Note 9) [7]		150,000		50,000
Deferred revenue [8]		10,000		50,000
		210,000		107,000

Net Assets

Invested in capital assets		950		-
Available [9]		(183,000)		(75,000)
		(182,050)		(75,000)
	\$	27,950	\$	32,000

Approved on behalf of the Board:

Director

Director

Troubled Society
Statement of Changes in Net Assets [10]

For the year ended March 31, 2013

	Invested in Capital Assets	Unrestricted	Total	
			2013	2012
Balance , beginning of year as previously stated	\$ -	\$ -	\$ (75,000)	\$ 20,000
Adjustment to prior period re: grant revenue (Note 12) [11]	-	-	-	(10,000)
As restated	-	-	(75,000)	10,000
Deficiency of revenue over expenses	(50)	(107,000)	(107,050)	(85,000)
Purchase of capital assets	1,000	(1,000)	-	-
Balance , end of year	\$ 950	\$ (108,000)	\$ (182,050)	\$ (75,000)

**Troubled Society
Statement of Operations**

For the year ended March 31, 2013

2013

2012

Revenue

Donations and fundraising [12]	\$	215,000	215,000
Fees and rentals		10,000	5,000
Training		3,000	100
Miscellaneous [13]		30,000	-
Government grants [14]		150,000	100,000
Interest		3,000	1,000
Administrative recoveries		3,000	3,000

		414,000	324,100
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Expenses

Advertising and promotion		5,000	1,000
Amortization expense		50	-
Bad debt expense [16]		25,000	5,000
Honourariums [17]		10,000	7,000
Insurance [18]		3,000	1,000
Interest charges [19]		10,000	5,000
Office expense and janitorial [20]		45,000	10,000
Rent [21]		100,000	75,000
Salaries and benefits [22]		316,000	299,100
Telephone and utilities		7,000	6,000

		521,050	409,100
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Deficiency of revenue over expenses [23]	\$	(107,050)	\$ (85,000)
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Troubled Society
Statement of Cash Flows [24]

For the year ended March 31, 2013

2013

2012

Cash provided (used) by

Operating activities

Operations

Deficiency of revenue over expenses \$ (107,050) \$ (85,000)

Item not involving cash

Amortization of capital assets 50 -

(107,000) (85,000)

Changes in noncash working capital balances

Accounts receivable (10,000) (12,000)

Accounts payable and accrued liabilities 43,000 7,000

Deferred revenue (40,000) 50,000

[25] **(114,000) (40,000)**

Investing activities

Acquisition of capital assets (1,000) -

Financing activity

Increase in operating loan [26] 100,000 50,000

Increase (decrease) in cash and shortterm deposits for the year [27]

(15,000) 10,000

Cash and shortterm deposits, beginning of year

20,000 10,000

Cash and shortterm deposits, end of year [28]

\$ 5,000 \$ 20,000

March 31, 2013

1. Purpose of the Society [30]

The Troubled Society (“the Society”) was incorporated under the Society Act of British Columbia on December 20, 1990 and is a registered charity under the Income Tax Act. The Society provides services to various marginalized groups and operates throughout the province.

2. Significant Accounting Policies

Use of Estimates	The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could materially differ from these estimates.
Capital Assets	Capital assets are recorded at cost and amortization is provided as follows: Equipment 10% straight line
Revenue Recognition	The Society follows the deferral method of accounting for contributions. Restricted contributions are recognized as revenue in the year in which the related expenses are incurred. Lottery proceeds are accounted for on a completed lottery basis. Unrestricted contributions and other revenues including interest, member assessments and certain recoveries of expenses are reported on the accrual basis provided amounts to be received can be reasonably estimated and collection is reasonably assured.
Contributed Services	The Society relies upon time donated by volunteers. Because of the difficulty of determining their fair value, contributed services are not recognized in the financial statements.
Expense Recoveries	Expense recoveries revenue includes administration costs charged to other organizations as well as charges to special projects carried out within the Society.
Financial Instruments	All financial instruments are classified into one of five categories: 1) Held for trading, 2) held to maturity investments, 3) loans and receivables, 4) available-for-sale financial assets or 5) other financial liabilities. All financial instruments are measured in the balance sheet at fair value

except for loans and receivables. Held-to-maturity investments and other financial liabilities are measured at amortised cost. Subsequent measurement and changes in fair value will depend on their initial classification as follows: held for trading financial assets are measured at fair value and changes in fair value are recognized in the statements of the revenue and expenses and changes in net assets. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income.

The Society has classified its financial instruments as follows:

- Cash and Term Deposits
- Held for trading
- Receivables
- Loans and receivables
- Payables and accruals
- Other financial liabilities

The carrying values of cash, term deposits, receivables and payables, and accruals approximate fair value due to the relatively short term nature of these investments.

It is management's opinion that the Society is not exposed to significant interest, currency or credit risk.

3. Future accounting changes [31]

Recent amendments to the Canadian Institute of Chartered Accountants (CICA) Handbook, section 4400 Financial Statement Presentation for Not-for-Profit Organizations, will modify the requirements with respect to various elements of financial statement presentation. These amendments include:

- Reporting certain revenues and expenses gross in the statement of revenues and expenses
- Making CICA Handbook Section 1540 Cash Flow Statements applicable to not-for-profits
- Amortizing capital assets reported as capital assets in the balance sheet regardless of the size of the organization
- When a not-for-profit classifies its expenses by function and allocates some of its fundraising and general support costs to another function, disclosing the policy adopted for expenses and amounts allocated from each of these two functions to other functions and
- Elimination of the requirement to treat net assets invested in capital assets as a separate component of net assets

CICA Handbook, section 4460 Disclosure of Related Party Transactions by Not-for-Profit Organizations, has been amended to align the definition of related parties to CICA Handbook Section 3840 Related Party Transactions. Related parties exist when one party has the ability to exercise, directly or indirectly, control, joint control or significant influence over the other. Two not-for-profit organizations are related parties

if one has an economic interest in the other. Related parties also include management and immediate family members.

Management does not expect the adoption of these sections to have a material effect on the Society's financial statements.

4. Adoption of new accounting standards [31]

The Society adopted the following new accounting standards during the year.

Capital Management

The Society adopted the CICA Handbook Section 1535 Capital Disclosures. The standard requires that the Society disclose information about the objectives, policies and processes for the management of its capital. The impact of this new accounting policy on the financial statements is disclosed in note 5.

5. Capital Disclosure [32]

The capital structure of the Society consists of net assets invested in capital assets and negative unrestricted net assets.

'Net assets invested in capital assets' represent the amount of net assets that are not available for other purposes because they have been invested.

'Unrestricted net assets' stand in a large negative position. This reduces the flexibility to use assets for future operations and provide financial flexibility and may impact the ability of the Society to continue as a Going Concern – See note 6.

The Society has no externally imposed capital restrictions.

6. Going Concern

The Society has a large, negative unrestricted net asset position and significant and recurring deficits which may jeopardize its ability to continue as a going concern. It is management's opinion that the Society will be able to continue as a going concern.

7. Cash and Shortterm Deposits

The Society's bank accounts and term deposit are held at one financial institution. The bank accounts earn interest from 0% to 0.4%. The term deposit, with a balance of \$20,000 (2012 \$20,000) earns interest at 4.45% (2012 4.15%) and matures on October 31, 2014.

8. Capital Assets

	2012		2011	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Office equipment	\$ 1,000	\$ 50	\$ 950	\$ -

9. Loan Payable and Subsequent Event

The Society has an operating loan due on November 9, 2013 [33] which bears interest at 10.25%, [34] calculated semi annually and repaid by monthly principal payments of \$1,500 plus interest. The loan is partially collateralized by the \$20,000 term deposit [35] (Note 1).

10. Commitments [36]

The Society has leases for its premises at \$8,333 per month and for equipment at \$2,500 per month, both of which expire on March 31, 2015.

11. Contingent Liabilities [37]

A number of legal claims have been initiated against the Society in varying and unspecified amounts. The outcome of these claims cannot reasonably be determined at this time.

12. Adjustment to Prior Periods

It was determined that grant revenue had been recorded for grants that were never ultimately approved. This error was corrected retroactively. [38]

Comments on Troubled Society Financial Statements

Comment [1]:

It is important to actually read the auditors' report. Often there is a focus on the consolidated numbers that are published in a newsletter or other form without the auditors' report attached. The auditors' report should be requested in order to get a complete picture.

[2]:

This is a very serious statement (known as an "audit qualification"). The auditors must have access to any and all information they deem necessary to form their opinion. If anything was held back, it calls management's integrity into question.

In a real-life situation this type of qualification might very well lead the auditors to deny opinion on the financial statements. A denial of opinion is extremely rare and very serious.

[3]:

This is another audit qualification, however this is the only type of qualification that is common and not serious.

When an organization collects cash donations (such as in a door-to-door campaign) there is often no way for the auditors to be sure that all the cash collected was reported to the charity. As a result, this type of qualification is given. The auditors do test though, that once the collectors bring the cash to the office, it is appropriately tracked and controlled.

[4]:

The going concern qualification is very unusual. It identifies a serious financial challenge that the Society may have staying in business and suggests that, in spite of management's opinion, the auditor has real misgivings about the way the statements are prepared and the organization's ability to continue operations.

[5]:

Cash levels have decreased significantly suggesting a deteriorating financial position.

[6]:

Accounts payable has increased significantly. This could be an indication that the organization is having trouble paying its bills and may be holding invoices back.

A director of this organization should ask if the GST and employee tax remittances are up to date as there is the potential for personal liability if these have not been paid.

[7]:

The loan balance has increased substantially. It looks like they needed the additional cash provided by their bankers to stay alive. It is shown as a current liability which means that it all must be repaid within a year. How will the organization be able to do that?

[8]:

Deferred Revenue, which represents funds received for programs that have not yet taken place, is down. This is part of the reason for the increased need for loan financing.

[9]:

Unrestricted Net Assets represent the accumulated earnings since the Society started. At negative \$183,000, this large and increasing deficit suggests that there is little likelihood of the Society surviving.

[10]:

In general, the Statement of Changes will usually not be of great value to non-accountants.

[11]:

Prior period adjustments are becoming less common because of limitations under GAAP. In this case, when an error is found in a prior year's financial statement, the error is retroactively adjusted and disclosed as an "adjustment to prior period". The fact that it is an error should at least raise a question in regard to the reliability of the records and perhaps even the capability of finance staff – particularly if there are adjustments made several years running.

[12]:

Donations are the same as the prior year. This is positive in that donors are not abandoning the organization.

[13]:

The increase in miscellaneous revenue is also positive. However, the Finance Committee should question the source of the revenue and ascertain whether it was a one-time gift or will be a recurring item. The source of an amount this size would normally be identified.

[14]:

A 50% increase in government grants is also positive. However, since expenses increased more than revenues, it may mean that the cost of delivering the services supported by the government grant are greater than the grant amount.

[15]:

Although revenues are increasing, the deficit is increasing. Why?

[16]:

Bad debt expense represents items that were reported as revenue in prior years but are now deemed to be uncollectable. It is unusual for an organization with revenues from funders and government to have any bad debts. The Finance Committee should question: Why do we have any bad debts at all and why the large increase?

[17]:

Honorariums: One would expect an organization in financial difficulty to be cutting back on such discretionary items. The Finance Committee should question this expense.

[18]:

Insurance costs have tripled. The Finance Committee should ask if there were claims or if there are new risk problems.

[19]:

Interest charges have tripled because of the loan increase.

[20]:

The office expense line has increased from \$10,000 to \$45,000. The Finance Committee should question this increase.

[21]:

The Finance Committee should question why there was a 33% increase in rent. One would expect the organization to be cutting costs where possible.

[22]:

Salaries and benefits are the largest single line item, representing 60% of costs. However, note that they have dropped from 73% of costs in the prior year, suggesting a major shift in the operating model. The Finance Committee should question this.

[23]

One of the most important indicators is the net results for the year. This organization lost a lot of money last year (\$85,000) and even more this year (\$107,050). Obviously, it cannot continue indefinitely with such losses. The full Board should be questioning management about plans for turning things around and should be ensuring that any Board liability issues are addressed.

[24]:

The Cash Flow Statement will be of limited use to most readers who are not accountants.

[25]:

This subtotal represents the net cash results from day-to-day activities so the subtotal itself is of importance although the lines above, that make it up, are not. This shows that day-to-day operations of the organization have used \$114,000 in cash this year (and \$40,000 last year). This is not sustainable.

[26]:

This shows that the loan balance increased \$50,000 last year and a further \$80,000 this year. It has allowed the organization to survive, but the questions the Finance Committee must answer are where additional funding for ongoing short-falls will come from in the short-term and how this loan will be repaid.

[27]:

An overall decrease in cash this year of \$15,000. Cash balances will fluctuate but the Finance Committee should ask why there was a decrease for the year and how the organization plans to turn the cash flow around to the positive.

[28]:

Overall magnitude of cash in the bank is always of importance.

[29]:

The Notes to the Financial Statements are among the most useful sources of information in the statements because they detail financial policies, assumptions and risk to the Society. Many accountants read the Notes first, then move to the more general numbers.

[30]:

The Purpose of the organization is always identified in the first note, with details on its tax status, and other useful information.

[31]:

Future accounting policies and the adoption of new accounting standards show how the complexity of financial statements for not-for-profit organizations is increasing.

[32]:

The Capital Disclosure is a new requirement which allows readers to understand how management and the Board are protecting the net assets of the organization to ensure sustainability. For our Society, this is a challenge as shown in the following Going Concern note.

[33]:

The loan is due in just a few months. The entire Board should understand how the organization plans to repay it and what the consequences will be if they don't.

[34]:

This is expensive financing at 10.25%.

[35]:

The loan is partially collateralized by a \$20,000 term deposit. Since the cash balance reported on the Statement of Financial Position is only \$5,000, this means that the bank account itself is overdrawn. What did the lender see the need for a deposit of this size against a loan of this size?

[36]:

The Commitments note is important to read because an organization must show every contract that it is committed to and the financial cost of those commitments for at least the next five years.

[37]:

It is important to read the Contingent Liabilities note because it will discuss items that could turn into a liability for the organization. "A number of claims" could be an indication of some real problems for the Society. The Finance Committee should question the nature of the claims, potential liability, action taken, etc. Accounting rules require that a best estimate of the ultimate liability be accrued as a liability on the books if it can be reasonably determined.

[38]:

It was previously mentioned that although it should be infrequent, many organizations will have adjustments for errors in prior periods from time to time. The error noted here though, seems particularly troubling as the organization was recording grant revenue before the grants were even approved. The Finance Committee should question management to ensure that the policy on recording of grant revenues has been changed.

Glossary of Terms

Accountability	The responsibility of a foundation/organization to publicly disclose information on their activities, particularly justification for financial activities and the decisions surrounding them. It is also the capacity to account for one's actions; or as a representative of one's organization, to account for either your actions or the actions of your organization.
Accounts payable	Amounts owed by an organization, eg. unpaid bills for purchases, monthly obligations, loan repayments.
Accounts Receivable	Amounts owed to an organization services or programs that the organization has delivered prior to receiving the income or provided for on credit.
Amortization	a) allocation of cost over the useful life of the asset in a rational and systematic manner. b) allocation of revenue (deferred contributions) over a number of periods to match expenses related to the revenue.
Annual General Meeting (AGM)	Typically the most important meeting an organization has each year. The governing Board, executive Director, and the general membership are normally present at an AGM.
Annual report	A report issued by the organization that provides financial statements and descriptions of its activities. Annual reports vary in format from simple typewritten documents to detailed publications that provide substantial information about the organization's programs, activities, services, plans, etc.
Arm's Length Transaction	A transaction that is conducted as though the parties were unrelated, thus avoiding any conflict of interest.
Articles of incorporation	A document filed with provincial or federal governments by persons establishing a corporation. This is the first legal step in forming a non-profit corporation.
Assets	What the organization owns or is owed to them as a result of past transactions or events. Can be hard, intangible, human, technical, proprietary, reputation, social.
Audit	Independent verification of economic events.
Auditor	A firm of Chartered Accountants hired to give an independent opinion on the organization's financial statements.
Auditor's Report	In an annual report, the auditor's opinion on the organization's financial data and supporting evidence.
Balance sheet	An accounting statement of an organization's financial condition as of a certain date, generally at the end of its fiscal quarter or year.
Basis Price	1/100th of 1% in yield; hence 50 basis points is 1/2 of 1%.
Bearish	An attitude or indication implying that prices are likely to experience a substantial decline.
Board of Directors	A group of volunteers chosen to govern the affairs of a non-profit organization.
Bonds	Marketable and non-marketable securities issued in Canadian or foreign currency with an original term to maturity in excess of one year

Budget	A financial report containing estimates of income and expenses.
Bullish	The attitude of someone who is anticipating a bull market, or the description of an event that is supposed to cause market prices to rise.
By laws	Rules governing the operation of a non-profit corporation. By laws often provide the methods for the election of Directors, the appointment of officers and the description of their duties, the creation of committees, and the conduct of meetings, etc.
CA	Chartered Accountant
Capacity Building	The process of building the potential for not-for-profit organizations to respond to the needs of the community they serve.
Capital Gain	The profit you get when you sell an asset, like an investment, for more than you paid for it.
Capital Loss	When the sale price of an asset is lower than its purchase price, you have a capital loss.
Capital reserve	Monies set aside for capital purposes.
Cash flow	The flow of monies into (receipts) and out of (disbursements) the organization.
Cash flow forecast	An estimate of when and how much money will be received and paid out of a business. It usually records cash flow on a month-by-month basis for a period of two years.
CGA	Certified General Accountant
Charity	As a noun, refers to a kind of non-profit organization that solicits and is able to accept donations or gifts from individual and corporate donors. A registered charity is a charity which has successfully applied to the federal government under the Income Tax Act for charitable status. An organization benefits from obtaining charitable status because it possesses the privilege of issuing official receipts to donors for their monetary contribution. This donor can, in turn, submit the receipt to Revenue Canada for a tax exemption.
CMA	Certified Management Accountant
Collaborative	A formal or semi-permanent partnership created between two or more organizations in order to better achieve mutually desired objectives.
Collateral	Property (real, personal or otherwise) pledged as security for a loan. Also, any supplementary promise of payment, such as a guarantee.
Collateral Mortgage	A loan backed up by a promissory note and the security of a mortgage on a property. The money borrowed may be used for the purchase of the property itself or for another purpose, such as a transitional house, group home, etc.
Constitution	A system, often a written document, which establishes the rules and principles by which an organization is governed.
Contingency planning	Allowing for financial flexibility in preparing a budget in order to meet unanticipated events.
Corporate giving program	A grantmaking program established and administered within a profit-making company. Gifts or grants go directly to charitable organizations from the corporation. Corporate giving programs do not have a separate endowment; their expense is planned as part of the company's annual budgeting process and usually is funded with a determined percentage of pre-tax income.

Corporate Sponsorship	Group sponsorship, normally from the business community. Corporate sponsorship is often done in exchange for publicity.
Cost	The amount paid or charged for something.
Credit Rating	Every piece of credit history information in your credit file is assigned a rating by the credit grantor. The most common ratings are “R” ratings. These are known as North American Standard Account Ratings and are the most frequently used. The “R” indicates that the item being described involves revolving credit. If you always pay on time, it will be coded an R1. If an amount was written off because you never paid it back, it is coded R9. The R ratings are a coding system that translates “on time”, “one month late”, “two months late”, etc., into two-digit codes
Credit Risk	The risk of loss one assumes under a financial contract that a borrower or a counterparty to a loan or other credit-related contract may default or fail to perform its obligations.
Debt	Money owed.
Default	A borrower defaults on his obligations when he fails to make a required payment of principal or interest at a specified time.
Deferred Revenue	Income for which the cash has been collected by the organization, but has yet to be “earned”.
Deficit	A deficiency in amount - an excess of expenditures over revenue.
Deliverables	Measurable outputs or change produced by a given program or activity. For example, the number of girls attending school in a given community increased by 50%, or the air pollution in a given area decreases by 30%.
Demand Loan	A loan that must be repaid in full, on demand.
Depreciation	The amount of expense charged against earnings by an organization to write off the cost of a plant or machine over its useful life, giving consideration to wear and tear, obsolescence, and salvage value.
Direct deposit	If you receive money on a regular basis (i.e. from a job, pension, allowance), your employer, the government or person paying the allowance can deposit the money directly into your account.
Disbursement	Payment.
Disbursement quota	The amount that a registered charity must spend each fiscal period on charitable activities or as gifts to qualified donees to keep its charitable registration.
Discretionary funds	Funds distributed at the discretion of one or more trustees or staff, which usually do not require prior approval by the full Board of Directors.
Donor	A person, group or organization that gives or donates something, usually funding, to a charity. A volunteer can “donate” services or time to help solicit further funding from sponsors.
Due Diligence	Process of investigating all risks associated with an organization or grantee.
Economic Development	Any effort or undertaking which aids in the growth of the economy.

EFT/POS	Electronic funds transfer (EFT) at the point of sale (POS). A payment option which allows consumers to pay for purchases by transferring funds directly from their accounts to a merchant's accounts.
Electronic Funds Transfer (EFT)	A system that transfers funds through electronic messages instead of by traditional means, such as cash or cheques.
Executive Director	A person employed by a non-profit organization to oversee operations and management and implement the policy decisions of the Board of Directors.
Expenditure	Actual expenses incurred at the end of a reporting period or a fiscal year.
Expense	A cost, eg. stationery and supplies, printing and duplicating, postage and telephone.
Fiduciary duty	The legal duty of acting wisely (such as in the case of investing money) on behalf of another. fiduciary responsibilities relates to holding a position of trust that requires a Board member to act honestly, in good faith, and in the best interests of the organization.
Financial Disclosure	Any and all information that affects the full understanding of an organization's financial statements. Some items may not affect the ledger accounts directly. These would be included in the form of accompanying notes, the financial disclosure. Examples of such items are outstanding lawsuits or tax disputes.
Financial report	An accounting statement detailing financial data, including income for all sources, expenses, assets and liabilities. A financial report may also be an itemized accounting that shows how funds were used by an organization.
Fiscal year	The accounting year of an organization, which may or may not be the same as the calendar year.
Fixed assets	Assets like machinery, land, buildings, or property used in operating a business that will not be consumed or converted into cash during the current accounting period.
Fixed expenses	Fixed operational costs that do not change with the volume of activities, such as rent for business premises, insurance payments, utilities, etc.
Form T3010A	The form required from all charities by the Federal Government detailing their activities and expenditure through the year. Charities are required to submit this form within six months of the end of their fiscal year.
Foundation	An organization or institution established by an endowment. It exists to distribute grant money to voluntary organizations or individuals, allotting some of the funds to provide for its future subsistence.
Four Pillars	A term used to describe the main types of financial institutions: banking, trust, insurance and securities
Fund	A sum of money or resources intended for a special purpose.
Funding cycle	A chronological pattern of proposal review, decision-making and applicant notification. Some donor organizations make grants at set intervals (quarterly, semi-annually, etc.) while others operate under an annual cycle.
GAAP	Generally Accepted Accounting Principles: A set of rules and guidelines for reporting financial information. Each country may have its own GAAP.
GIC	Guaranteed Investment Certificate: An investment in which you deposit money, over a fixed period of time, and are paid a set rate of interest.

Gifts in-kind	Donations made to an organization in some form other than money. Some examples of gifts in-kind include labour, land, food, clothing, office space, furniture, or advertising. Gifts in-kind may also be called in-kind donations.
Governance	Refers to the actions of the volunteer Board of Directors of an organization with respect to establishing and monitoring the long-term direction of that organization's values and goals through policy and procedures.
Grant	A sum of money given by a donor to support the work of a Not-for-Profit Organization.
Infrastructure	Base or foundation of a world system (ie. economy, society, organization). It is the basic equipment required for a particular system to function.
Insurance	Coverage by contract whereby one party agrees to indemnify or guarantee another against loss by a specified contingent event or peril.
Internal control	All measures taken to safeguard assets; check the accuracy and reliability of accounting data; promote operating efficiency; and ensure compliance with the organization's policies and legislation.
Investment	Using money to provide income or profit.
Investment Income	This is income earned on investments you make. Investment income includes interest, dividends and capital gains.
Invoice	Bill for goods or services received or provided.
Journal	A record of transactions, can be manual or computerized.
Lease	An agreement to rent for a period of time at an agreed price.
Letter of Credit	A written undertaking from a bank guaranteeing payment.
Leverage	The use of borrowed money to buy more of an asset than would otherwise be possible in order to increase the potential profit earned on that asset. Used in fundraising as a small, initial investment by an organization in order to create tools to attract and raise additional funds.
Line of Credit	An agreement negotiated between a borrower and a lender establishing the maximum amount of money a borrower may draw. The agreement also sets out other conditions, e.g., how and when money is to be repaid.
Liquidity	Has to do with how easy it is to turn your investments quickly into cash, without a major penalty. Some investments, such as mutual funds, let you cash out on short notice. With others, it depends on how easy it is to find a buyer on the open market. Note: Law or the contract terms may stop you from reselling some securities for months or even years.
Long-term liabilities	Money that you owe over a period longer than 12 months, such as mortgages, bank loans and other obligations.
Minimum monthly balance	The least amount of money that has been in a bank account during the whole month.
Mission Statement	A brief statement outlining the specific task(s) for which a group has charged itself.
Money Markets	The part of the capital market where government Treasury bills, commercial paper, bankers' acceptances and other short-term obligations are bought and sold

Mutual Fund	An investment product in which your money is pooled with the money of many other investors. A professional manager(s) uses the pooled money to buy a portfolio of investments or securities, and monitors each of the investments on an ongoing basis. There are many varieties of mutual funds, each with specific objectives. By investing in a mutual fund, you purchase units of that fund. The value of your units can go up or down depending on the type and performance of the mutual fund
Notes and Disclosures	A detailed set of notes immediately following the financial statements contained in the annual report that expands upon and/or explains in some depth the information contained in the financial statements.
N.S.F. Cheque	Not Sufficient Funds. If a cheque is returned for this reason, it means that there was not enough money in your bank account to cover the amount of the cheque. There is a fee to you if this situation occurs
Operating Loan	A loan intended for short-term financing, supplying cash flow support or to cover day-to-day operating expenses.
Operating Expenses	All of the elements of an organization's cost of doing business, such as salaries, rent, depreciation, and others. Some of these expenses are fixed and some are variable.
Overdraft	The withdrawal from a bank account of an amount greater than the positive balance in the account. Often used to refer to a negative balance in one's account.
Policy	A course or principle of action adopted by a government, party, business or individual.
Prime Lending Rate	The rate of interest charged on loans by credit unions, banks, trust companies to their most creditworthy customers.
Promissory Note	1) An unconditional promise to pay on demand or by a fixed date a certain amount of money. 2) A written promise to pay money or money's worth usually for goods and/ or services received.
Ratio	Comparison of two figures used to evaluate business performance, such as debt/equity ratio and return on investment.
Reconciliation	Checking all bank account papers to make sure that the bank's records and your records agree.
Request for Proposal (RFP)	An RFP is similar to a job posting, but for a contractor for a specific project. It lists project specifications and application procedures.
Return	Any increase in value or in income you earn on an investment.
Risk Tolerance	Your comfort level with accepting possible losses from your investments.
Rule of 72	A simple formula that tells you roughly how long it will take to double your money. Formula: Divide 72 by the interest rate or the rate you expect your money to grow in an investment. Example: an investment growing at a rate of 8% per annum could be expected to double in value in approximately nine years.
Securities	Investments such as stocks and bonds.
Sponsor	A person or organization, usually a business, that supports an activity by pledging money in advance.

Statement	A computer printout which lists all the transactions in a bank account for a period of time. Statements are usually given once a month.
Stocks	Traded on a stock exchange, these are shares in a company. Essentially, you purchase shares in exchange for owning a part of that company.
Strategic Plan	A future-oriented perspective where organization's decisions are made based on an analysis of external and internal trends and data.
Sustainability	The ability to meet the needs of today's people and environment without compromising that of subsequent generations. When a program seeks to create sustainability, it aims to create an environment that can renew itself without damage to future stakeholders.
Term deposit	An investment in which you deposit money, over a fixed period of time, and are paid a set rate of interest.
Term Loan	A loan intended for medium-term or long-term financing to supply cash to purchase fixed assets such as machinery, land or buildings or to renovate business premises.
Treasury Bills (T-Bills)	Short-term government obligations that are payable to the bearer and sold on a discount basis; the difference between a T-bill's market or discounted price and its face or redemption value is effectively interest if the T-bill is held to maturity.
Variable expenses	Costs of doing business that vary with the volume of business, such as advertising costs, manufacturing costs and bad debts.
Venture Capital	Commonly refers to funds that are invested by a third party in a start-up business either as equity or as a form of secondary debt.

Resources

The Canadian Revenue Agency

The CRA has the responsibility of issuing charitable registration numbers and monitoring the activities of charities. From a relatively passive role, they are becoming increasingly involved in monitoring the activities of charities, with some of the objectives being restricting funds flowing to terrorist organizations, ensuring that tax receipts are appropriately issued, monitoring the cost of fundraising, supporting the volunteer sector and ensuring timely reporting by charities of their T3010 information.

One particularly useful resource is to provide greater transparency for the public, particularly donors, to access information on any Canadian charity. Go to the CRA website, access the Charities and Giving icon on the left, go to the Charities Listing and input the charities name. Information available includes most of the T3010 information including the assets, liabilities, revenues and expenses, salary ranges of the top10 employee, types of fundraising etc. All Treasurers should look at the information that is available on their organization and consider looking up similar organizations to see how finances compare.

The CRA also has a Charities Hotline at 1-800-267-2384 where experts will respond to questions – particularly useful for charitable receipt questions. There are also a variety of other resources through their website. One of particular interest is the Toolbox for directors, officers, and volunteers at <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/tlbx/menu-eng.html> which helps registered charities understand and meet their requirements and obligations and familiarize themselves with important information required to maintain their charitable registration.