

**PRENTICE
YATES &
CLARK**
CHARTERED
PROFESSIONAL
ACCOUNTANTS

**READING AND
UNDERSTANDING
FINANCIAL STATEMENTS**

PRENTICE YATES & CLARK
NOVEMBER 2015
Presented by:
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Financial Reporting

- ▶ Annual Audited Financial Statements (AFS)
- ▶ Annual Report
- ▶ Internal Financial Statements
- ▶ AFS
 - Report the NPO's accounting records
 - Standard format
 - Include all the requirements to comply with auditing and accounting standards

A Story to Tell

- ▶ Financial Health
 - Cash and investment position
 - Receivables, Payables, Loans
- ▶ Trends
 - Best 5 years (AFS only report 2 years)
 - Watch out for one-time events
 - Cannot predict future
- ▶ Analyze
 - Operations for the year, revenues and expenses
 - Receivables and payables

A Story to Tell

- ▶ Ask Questions
 - Why is this happening
 - E.g. Why are receivables increasing? Why is revenue from a particular source decreasing?
- ▶ Understand the Issue
- ▶ Decide on how to improve the situation
 - Work together to fix the problem
 - Make informed decisions
- ▶ Follow up on a regular basis
 - Incorporate upcoming trends
 - E.g. expected decreases in government funding

Financial Statements (FS)

- ▶ Financial Statements
 - Auditors' Report
 - Statement of Financial Position
 - Statement of Operations
 - Statement of Cash Flows
 - Notes to Financial Statement

Auditors' Report

- ▶ Introductory Paragraph
 - Statements audited and Accounting Rules
- ▶ Board of Directors' Responsibility
 - Board of Directors responsible for the AFS
- ▶ Auditors' Responsibility
 - Auditor responsible to provide an opinion
- ▶ Opinion Paragraph

Auditors' Report

▶ Basis for Qualified Opinion Paragraph
“In common with many charitable organizations, the Corporation derives revenue from donations, the completeness of which is not susceptible to satisfactory audit verification. Accordingly, our verification of this revenue was limited to the amounts recorded in the records of the Corporation and we were not able to determine whether any adjustments might be necessary to revenue, surplus, assets and net assets.”

Auditors' Report

- ▶ Qualified Opinion
 - “...except for the possible effects of the matter described in the Basis for Qualified Opinion...”
 - “...the financial statements present fairly, in all material respect...”
 - “...in accordance with Canadian generally accepted accounting principles...”
- ▶ Watch out for other paragraphs
 - Emphasis of Matter paragraph
 - Other Matter paragraph

Auditors' Report

- ▶ Basis of Accounting and Restrictions on Use
 - Financial Reporting Framework Prescribed by the Funder
 - Canadian Accounting Standards for Not-for-Profit Organizations, with exceptions
 - Standard for NPO Housing/Co-operatives
 - Users – Board, Members, Funder

Statement of Financial Position

$$\text{ASSETS} = \text{LIABILITIES} + \text{EQUITY}$$

Financial Position – Example

- ▶ NPO started operations on Nov 1, 2015. On Nov 16, 2015, it receives a donation of \$1,000 that is deposited in the bank.
- ▶ Position as of November 30, 2015:

ASSETS		Liabilities & Equity	
Cash	1,000	Liabilities	0
		Equity	1,000
Total	1,000	Total	1,000

Financial Position – Example

- ▶ On Dec 15, 2015, the NPO borrows \$5,000 to purchase office equipment.
- ▶ Position as of December 31, 2015:

ASSETS		Liabilities & Equity	
Cash	1,000	Liabilities	5,000
Capital Assets	5,000	Equity	1,000
Total	6,000	Total	6,000

Cash and Investments

Cash and Investments

	2015	2014
Cash		
Petty cash	\$ 1,000	\$ 1,000
Operating current accounts	98,087	88,098
Brokers' cash accounts	50,000	0
Temporary Investments		
Guaranteed investment certificates	100,000	50,000
	249,087	139,098
Long-Term Investments		
Guaranteed investment certificates	150,000	250,000
	399,087	389,098

Cash and Investments

- ▶ Total cash and investments at year end
 - Increase or decrease
 - Temporary or real
- ▶ Enough cash and investments to cover restricted funds
- ▶ Operating current account
 - Excess cash in non or low-interest bank account
 - Oversight or Intentional
 - Not allowed to invest (per funder)

Cash and Investments

Investments

- ▶ Short-term vs Long-term
- ▶ Composition, GICs, Bonds, Equity, etc.
 - Risk level
- ▶ Balance between high rate of return and acceptable level of risk
- ▶ Plan for extensive cash inflows or outflows

Cash and Investments

- ▶ Conform to Investment Policy
- ▶ Board of Directors approve sales/purchases
- ▶ Board of Directors review investments
- ▶ Charities in Ontario follow Trustee Act
 - 27(1) - "exercise care, skill, diligence and judgment that a prudent investor would exercise"
 - 27(3) - "may invest in mutual funds, pooled fund, segregate funds"
 - 27(5) - lists criteria
 - 27(6) - requires diversification
- ▶ NPO Housing/Co-operative - SHRA

Receivables

- ▶ Amount can be reasonably estimated and
- ▶ Collection is reasonable assured

- ▶ Donations receivable
- ▶ Grant/Funding
- ▶ Tenant/Member receivables

- ▶ Questions
 - What do receivables consist of?
 - Collection after year end. Follow up.
 - Increase/decrease compared to prior year

Receivables - Sample - Funding

- ▶ NPO has a December 31 year end
- ▶ Receives grant for total \$100,000

Date Received	Grant
05-Jan-15	\$ 30,000
30-Apr-15	\$ 50,000
25-Jan-16	\$ 20,000 Receivable
	<u>\$100,000</u>

Receivables – Pledges, Bequests

- ▶ Receivable?
- ▶ Pledges
 - Typically criteria is not met
 - Large organizations with history of collections “may” do an estimate
- ▶ Bequests
 - Criteria not met, timing and amount
- ▶ Recognize when received

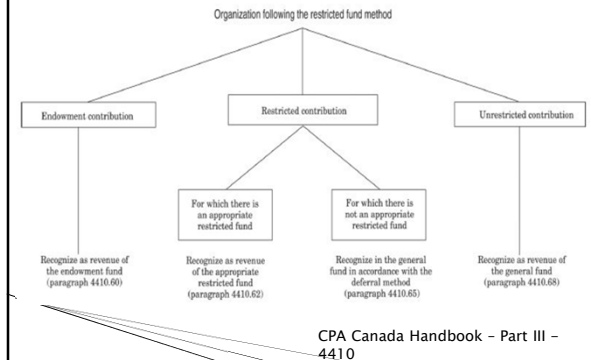
Fund Accounting vs Deferral Method

- ▶ Fund Accounting
 - Description and purpose each fund
 - Consistent funds
 - Revenues and expenses for each fund
 - No deferral (unless there is no fund)
 - Proper allocation of revenues and expenses between funds
- ▶ Deferral Method

Restrictions – Fund Accounting

- ▶ Endowment contributions
 - External
 - Endowment fund balance
- ▶ Internally restricted funds
 - Board of Directors
 - Restricted fund balance
- ▶ Externally restricted contributions
 - Donor, funder, etc.
 - Restricted fund balance
- ▶ Externally restricted contributions – no appropriate fund
 - Deferred contributions in general fund

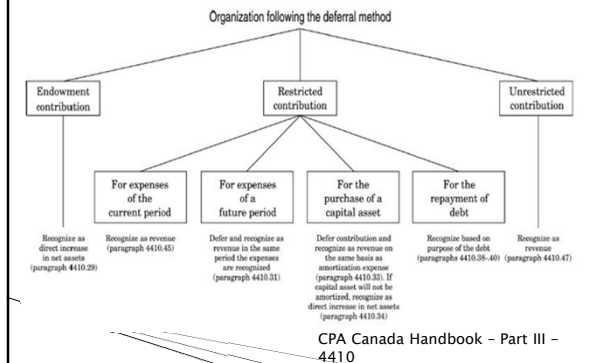
Decision Tree – Restricted Fund



Restrictions – Deferral Method

- ▶ Endowment contributions
 - External
 - Net assets – permanent endowment
- ▶ Internally restricted funds
 - Board of Directors
 - Net assets
 - Transfers between net assets
- ▶ Externally restricted contributions
 - Donor, funder, etc.
 - Deferred contributions

Decision Tree – Deferral Method



Capital Assets

- ▶ Building, office equipment, computers, software
- ▶ Capitalization policy
- ▶ Capital vs operating
- ▶ Review additions
- ▶ Amortization policy
- ▶ Amortization expense

Liabilities

- ▶ Accounts payable
- ▶ Government related payables – separate line
- ▶ Accrued liabilities
 - Accrued utilities
 - Accrued overtime, vacation – policy
 - Reasonable estimates
- ▶ Payable back to funder – why
- ▶ NPO housing – member/tenant deposits

Deferred Contributions

- ▶ Comparison to prior year
 - Recurring grant/funding program
 - Timing of receipt
- ▶ Appropriate to defer – purpose
 - Received for next fiscal year
 - Received special project – restricted by donor
 - Ensure not payable back to funder

Net Assets

- ▶ Externally restricted funds
 - Funder, donor, etc.
 - Proper allocations to the fund
 - Capital Replacement Reserve (NPO housing)
- ▶ Internally restricted funds
 - Board motion, minutes, etc.
- ▶ Unrestricted

Net Assets - Example

	Internally Restricted Capital Fund	Unrestricted Funds	Total
Opening	0	230,000	230,000
Surplus	0	35,000	35,000
Ending	0	265,000	265,000

Net Assets - Example

	Internally Restricted Capital Fund	Unrestricted Funds	Total
Opening	0	230,000	230,000
Surplus	0	35,000	35,000
Transfer	100,000	-100,000	0
Ending	100,000	165,000	265,000

Donations, Bequests

- ▶ Type of donation
- ▶ Restriction? Purpose? Timing?
- ▶ Record as revenue in current year, defer in next fiscal year?
- ▶ Donation receipt
- ▶ Fluctuations in donation revenue
- ▶ Reliance on donations
 - Ratio donation revenue/total revenue

Donated Goods and Services

- ▶ Policy – Disclose in FS and follow policy
- ▶ Option to record as revenue
 - Fair value – Appraisal
 - Goods or services would have otherwise been purchased
- ▶ Corresponding expense
- ▶ Consideration CRA perspective
 - Services do not qualify for donation receipt
 - Backup for fair value estimate

Government Subsidies

- ▶ Depends on different factors
 - Funder – MCSS, CMHC, Municipal, etc.
- ▶ Based on funder approved budget
- ▶ May require reconciliation based on actual costs
 - Mortgage expense
 - Property tax expense
 - Rent geared income subsidy
- ▶ May be fixed – no additional subsidy
- ▶ May include a surplus repayment
- ▶ May be project-based – non-financial information reporting requirements

Government Subsidies

- ▶ Understand the funding formula
- ▶ Budget subsidy based on formula
- ▶ Maximize subsidy (following rules)
- ▶ Estimate payable before year end
- ▶ Apply for one-time grants, if possible
- ▶ Discuss problems with funder representative before year end

Rents

- ▶ For NPO Housing/Co-operative, one of the two major sources of revenue (rent and subsidy)
- ▶ Easy to calculate - potential rent
- ▶ Budget for rent increases
- ▶ Do not net vacancy losses against rents

Vacancy Losses

- ▶ Ideally should be close to \$0
 - Time lag between move out and move ins
 - Unit renovations for move in
 - Centralized waiting list - longer process
 - Geographical area - difficult to fill units
 - Rents close to market value in area
- ▶ Percentage of total rents
- ▶ Look for fluctuations, e.g. sudden increase
- ▶ Market vs RGI vacancy loss (SHRA)

Investment Income

- ▶ Combine amount in statements of operations and statement of replacement reserve (NPO Housing)
- ▶ Look for variances
- ▶ Many factors
 - Market conditions, interest rates, type of investments
- ▶ Refer to cash and investments note
- ▶ Enquire investment composition

Expenses

- ▶ Compare to prior years (5 years)
- ▶ Compare to budget
- ▶ Should be able to explain variances
- ▶ Review should be done monthly
 - No surprises at year end
- ▶ Controllable and non-controllable

Expenses – Payroll

- ▶ Generally largest expense for NPO
- ▶ Look for breakdown in the trial balance – payroll expense consists of
 - Review by division, by staff level
 - Pay rates?
 - Overtime, vacation, benefits, source deductions
 - Expenses from expense reports
 - Bonuses
 - Contractor – not part of payroll

Expenses – Utilities

- ▶ Utilities – Five year analysis
- ▶ Low – Have bills been paid? Accruals?
- ▶ High – Misallocation? Rates? Consumption?
- ▶ Ways to conserve energy
 - Educate tenants/members
 - Energy efficient measures
- ▶ Further analysis
 - Check consumption and rates on utility bills
 - Read brochures notifying about upcoming changes

Other Expenses

- ▶ Insurance expense
 - Compare rates, similar coverage, quality of service
- ▶ Amortization and mortgage interest – NPO Housing
 - Equal to monthly mortgage payment x 12 months
 - Set terms, change at renewal
 - Funder may help at renewal
- ▶ Amortization – based on useful life of assets
- ▶ Municipal taxes
 - Set annually
 - Charities rebate – 40% of property tax
- ▶ Replacement reserve – NPO Housing
 - Funder or Co-operative budget

Questions & Answers
