

# Accounting Athletics 101

## Running a Financially Healthy Not-for-Profit Organization

Presented by

**Vancity**

citizensbank<sup>TM</sup>  
of canada



Human Resources and  
Social Development Canada

Ressources humaines et  
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## Introduction to the Financial Fitness Series

Vancity is very pleased to be able to participate in the development of these Financial Fitness materials for not-for-profit organizations. In our extensive work in the social and voluntary sector, it is a commonly expressed need for organizations to move themselves further along the curve of understanding what it takes to be a healthy, financially strong and stable organization.

Vancity, which is incorporated under the Credit Union Incorporation Act, has been helping British Columbia's organizations make the most of their assets and resources for many years. Vancity is Canada's largest credit union, with \$12 billion in assets, more than 340,000 members, and 51 branches throughout Greater Vancouver, the Fraser Valley and Victoria.

Citizens Bank of Canada is an online bank and a wholly owned subsidiary of Vancity, serving members across the country via the internet, 24-hour Service Centre and ATM network. The Vancity Group of Companies is guided by a commitment to corporate social responsibility, and to helping members and communities thrive and prosper.

At Vancity, we use our unique skills and expertise as a financial institution to create solutions to social, environmental and economic issues. Through innovative loan programs and deposit products, Vancity and its members are working to make a difference in communities here and around the world.

While there are a wide variety of support services available to assist entrepreneurs in developing healthy for-profit ventures, there appears to be a distinct lack of broad based informational supports for the not-for-profit sector. In 2006, Human Resources and Skills Development Canada (HRSDC) held a series of policy dialogues across Canada on social enterprises and the social economy. In many of the discussions practitioners talked about the challenges of effectively managing their organizations and enterprises. In response to the dialogues HRSDC has partnered with Vancity to develop the Financial Fitness Series. Vancity is grateful to, and acknowledges the foresight of HRSDC for their support in making the preparation of these handbook, and delivery of accompanying workshops possible.

In putting together the content for the three handbooks of the Financial Fitness series, Vancity has been able to leverage work already being done in the sector to provide education and training to enhance not-for-profit organization sustainability. It is Vancity's core belief that an organization's ability to make effective and enduring use of funding, whether in the form of grants, fee-for-service revenues, or bank loans, comes from a strong ability to organize, plan, manage and track the use of funding against pre-determined objectives.

In order to provide the most useful and streamlined information, we have brought together the resources of experts in the areas of legal matters pertaining to not-for-profit organizations, accounting issues which are most germane to the sector, and financial considerations to build healthy organizations. While there are considerable overlaps across these three areas, each has its own unique aspects which are deserving of more focused attention. We have constructed the handbook series in such a way as to provide an effective stand-alone presentation on each subject area, while maintaining a cohesive and uniform presentation style to facilitate a more robust educational experience that incorporates all three subjects.

The information and materials contained within this handbook are designed to assist individuals in the key management and Board roles within most not-for-profit organizations. The handbooks will be providing a crucial support piece to the delivery of a related workshop for each of the subject areas. However, acknowledging the widespread need for this information to be disseminated across the country, the workbook design will allow a user to understand the desired learning outcomes, gauge their own and organizational readiness in the subject area, and work through the core content and case material in a way which will not be entirely dependent on workshop attendance in order to receive significant value.

It is Vancity's hope to assist organizations in Canada by providing a more robust toolkit of skills and resources, and to assist with identifying areas for further development. We honour your work and your desire for self and organizational development and look forward to making this journey together.

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## Accounting Athletics Self-assessment

The following is pre-test about accounting best practices for not-for-profit organizations. It is designed to help you assess your base knowledge of this topic. The answers to these questions can be found throughout the text of the handbook and on page 58.

1. **Select the statement which is most accurate:**
  - a. The main difference between accounting for a not-for-profit organization and a for-profit corporation has to do with how to report funding that is received and passed on to other organizations.
  - b. The main difference between accounting for a not-for-profit organization and a for-profit corporation is that not-for-profits cannot show a positive profit line and for-profits strive to show a positive profit line.
  - c. Accounting practices used for not-for-profit organizations are very different from accounting practices used for for-profit corporations.
  
2. **True or False:** Generally Accepted Accounting Principles (GAAP) are mandated by law and are, for the most part, static rules that must be followed.
  
3. **How much “profit” is generally acceptable on a not-for-profit’s balance sheet?**
  - a. 10% of the revenue generated in the year being reported on
  - b. 10% of the overall budget of the year being reported on
  - c. Three to six months worth of committed operating expenses
  - d. No amount. The balance sheet must not show a net surplus of income over expenses.
  
4. **True or False:** The Notes and Disclosures portion of an organization’s financial statements are of little importance compared to the actual numbers that are reported in the statements.
  
5. **What are the three levels of reports an external accountant can prepare for a not-for-profit organization?**

6. There are four basic financial statements used by organizations that are managing their finances well. **Match each of these financial statements with their brief description:**

<b>Financial Statement</b>	<b>Description</b>
Financial Position	Summary of the sources and use of cash in the organization.
Operations	Summary of where money moved over the course of a year and is most useful when used to compare year-to-year data.
Changes in Net Assets	Snapshot of an organization's assets and liabilities on a particular <i>day</i> .
Cash Flows	Summary of revenues and expenses for a particular period, most often one year.

7. Contributions are unique to not-for-profit organizations. **Select all the types of contributions that a not-for-profit can report.**
- Personal
  - Restricted
  - Project
  - Unrestricted
  - Endowment
8. **True or False:** GAAP policies on how contributions receivable should be treated are very strict.
9. **Match the capital asset category with common examples that represent that type of asset.**

<b>Capital Asset</b>	<b>Common Example</b>
Current Asset	Real estate, plant, equipment
Long-term Asset	Trademarks, patents, copyrights, goodwill
Pre-paid and deferred Assets	Cash and liquid items
Intangible Assets	Insurance, rent, interest

10. There are three basic types of internal control that an organization should put in place to ensure people and processes are working as they should be. These **internal controls are:**
- Operational controls
  - Conduct controls
  - Financial controls
  - Compliance controls
  - Reporting controls

## Introduction

Much of the funding which supports the work of not-for-profit organizations comes from the outside or from government agencies. Most, if not all, funders are looking for appropriate diligence around the organization's ability to effectively deploy the funding and the tracking of how the funds are used.

In the following sections, we will address some of the key elements which are fundamental in creating a standardized approach to financial recording, as well as focus on several areas which are of specific interest to not-for-profit and charitable organizations.

Starting with a review of some of the standardized industry principles of accounting and a discussion of considerations of taxation, the first section also explains the different levels of review which accountants can perform, depending on the requirements and audience of the organization. Financial statements are made up of a number of individual statements, each with its own purpose, and a detailed discussion of these statements is the focus of the second section.

Subsequent sections cover such areas as the unique elements and types of revenue for not-for-profit organizations, appropriate accounting treatment for Capital Assets, and some accounting best practices. Also, there is significant attention to the necessary accounting elements relating to Human Resource management in order to provide support for this important aspect of organizational operations.

While effective accounting practices may sometimes seem the furthest thing from an organization's key mandate, it is important to understand the reasons for attention to this aspect of organizational management, and to appreciate the value brought to the organization by the assistance of qualified experts in the field. An appreciation for how to make best use internally of the financial reports available can provide a strong connection between Board members and staff within the organization.

The need for effective financial recording and management is one of the elements which is a common thread among all organizations, be they a for-profit or a not-for-profit organization. Careful attention to financial flows through the organization supports overall organizational stability and resilience.

# 1. Not-for-profit financial reporting and accounting issues

Not-for-profits *typically* are reporting to a wider cross-section of the community than private, for-profit organizations which are mainly reporting to owners who are interested in maximizing profit. NPOs must show a wide community of funders, members, government and communities that the NPOs are meeting their missions with the money they have raised and are spending that money wisely and appropriately.

Many of the accounting issues are the same between private sector and not-for-profit sector organizations. However, there are certain areas that are recognized as different, which is why there are special accounting rules for NPOs.

The most important accounting issue, that is unique to not-for-profit organizations, has to do with funding that is received and funding that is passed on to other organizations to meet their mandates. Because funding cycles in the not-for profit sector are so long – organizations often deal with annual grants in which they receive a large chunk of project or operating income all at once. If they record all revenues upfront when the cash is received they look flush with resources; but they still have to provide the services that the funder is paying for which will cost money. The accounting rules on contributions is important and revenue should be recorded to match the expenses.

The Canadian Institute for Chartered Accountants (CICA) Standards and Guidance Collection, otherwise known as the CICA Handbook, is the primary source accountants and not-for-profit management turn to for guidance for accounting standards. Section 4400 of the CICA Handbook applies to not-for-profit organizations and deals with matters that are unique to not-for-profit organizations. This section of the Handbook also addresses different needs of the readers and users of financial statements of not-for-profit enterprises.

The question to ask is *why* not-for-profits have special financial reporting and accounting issues, when compared to for-profit enterprises.

## Generally accepted accounting principles

### What is GAAP and why is it important?

Generally Accepted Accounting Principles (GAAP) are the 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.

GAAP is important for two reasons. First, it describes how all organizations should state their finances, so not-for-profits aren't inventing unique ways of reporting their position; there are simple rules to be followed. Second, it allows comparability, both year to year for an organization and at any given time, between different organizations because everyone is following the same principles. This comparability is important because it allows management, funders, members, government and other stakeholders to analyse how well their not-for-profit organization is doing compared to other similar organizations and compared to previous years.

Interestingly, GAAP not only are somewhat fluid, but they come from a variety of sources as diverse as findings from academic research studies to best practices in other countries. Some of the GAAP are codified in the CICA Handbook, which is 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 the situation at hand.

In the absence of a primary source of GAAP, or if additional guidance is needed to apply a primary source to specific circumstances, public sector reporting entities must exercise professional judgment and adopt accounting policies and disclosures that are consistent with:

- 1) the primary sources of GAAP; and
- 2) the application of Section PS 1000, *Financial Statement Concepts — Federal, Provincial & Territorial Governments*, or Section PS 1700, *Objectives of Financial Statements — Local Governments*.

A public sector reporting entity required to prepare financial statements in accordance with regulatory, legislative or contractual requirements can describe the basis of accounting as in accordance with GAAP only when those requirements are within the range of

“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.”

CICA Handbook, Section 1100.

GAAP key requirements are found in section 1150 of the CICA Handbook and are as follows:

Public sector reporting entities are to apply every primary source of GAAP.

The primary sources of GAAP, in descending order of authority, are:

- 1) CICA Public Sector Accounting (PSA) Handbook Sections PS 1200-3800;
- 2) Public Sector Guidelines; and
- 3) Appendices and illustrative material of those pronouncements described.

acceptable choices allowed by the proposed Section.

It's important to note that all external, general purpose financial statements must follow GAAP and have very specific structures which must be followed. Internal statements, however, can be prepared on any base of accounting and can highlight what's important to management. That is why accountants will always refer to internal statements as management tools. Although there are no restrictions on how internal financial statements must be prepared, it is in the interest of all not-for-profits to ensure a close correlation between external and internal statements: efficiencies are achieved when the internal and external statements are aligned in presentation, and assurances are made to management and the Board that everyone is working with the same information.

### **Cash versus accrual methods of accounting**

There are two principle methods for keeping track of your organization's income and expenses: the cash method and the accrual method. The only difference between cash and accrual method accounting is in the timing of when you credit or debit your account with income and expenses.

Using the cash method, income and expenses are recorded on your books as the cash comes in the door or leaves. 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 written. And on the income side, the cash is counted only after it has been deposited in the bank.

Using the accrual method, the income and expenses are recorded as soon as 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 again on the income side, that money is counted as soon as the donation or sale comes in the door. You don't have to wait until you see the money in your account, or actually pay money out of your account, to record the transactions.

The question that begs to be asked is, if the accrual method of accounting is so much better than the cash method, why do some organizations use the cash method? The answer is that it is easier, and can be less expensive to manage. It doesn't require an organization to "book" payables and receivables; the organization simply writes cheques and records payments as they go out the door. If you are a one or two person organization, or all volunteer, it may not make sense to spend time and money in accrual

The accrual method is the more commonly used method of accounting since the cash method doesn't provide your organization with a complete or accurate picture of your financial situation at any given time.

accounting. For organizations that need to buy accounting software, there can be a financial savings by not buying accounting modules to deal with payables and receivables (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). And for small organizations that write a handful of cheques a month, it can be too much of an administrative burden to use the accrual method.

However, at year-end, accrual method needs to be used to create financial statements that accurately reflect the actual financial position of an organization (including outstanding payables and receivables that would not be reflected in cash accounting), it is generally best for organizations of any size beyond a simple volunteer staff to set up the systems based on the accrual method all year long. A consultation with the accountant who provides your year end review will help determine if it time to move from the cash method to accrual accounting.

### **Cash versus accrual method accounting example**

#### **Assumptions:**

Organization has received a \$200,000 grant and has completed half of the outcomes required as per the grant submission.

Organization has paid \$15,000 for computers used for operations. Bought one year ago, useful life of three years.

Organization has earned \$2,000 on cash and investments that will be received at end of year.

Organization has purchased a \$5,000 liability insurance policy that is half-way through its term.

Organization has \$30,000 in bills that have not been paid yet

	<b>Cash Basis</b>	<b>Accrual Basis</b>	
<b>Statement of Operations</b>			
Revenues			
Grant revenue	\$ 200,000	\$ 100,000	
Interest revenue	\$ -	\$ 2,000	
	<u>\$ 200,000</u>	<u>\$ 102,000</u>	
Expenses			
Salaries and benefits	\$ 80,000	\$ 80,000	
Amortization expense	\$ -	\$ 5,000	
Office expenses	\$ 15,000	\$ 42,500	
	<u>\$ 95,000</u>	<u>\$ 127,500</u>	
<b>Excess (deficiency) of revenue over expenses for the year</b>	<b>\$ 105,000</b>	<b>\$ (25,500)</b>	Note that the cash method shows a very profitable year, when there's actually a loss on an accrual basis
Net assets, beginning of year	\$ 52,000	\$ 67,000	
Net assets, end of year	<u>\$ 157,000</u>	<u>\$ 41,500</u>	
<b>Statement of Financial Position</b>			
Assets			
Cash and investments	\$ 157,000	\$ 157,000	
Accounts receivable	\$ -	\$ 2,000	
Prepaid expenses	\$ -	\$ 2,500	
	<u>\$ 157,000</u>	<u>\$ 161,500</u>	
Property and equipment	\$ -	\$ 10,000	
	<u>\$ 157,000</u>	<u>\$ 171,500</u>	
Liabilities			
Accounts payable	\$ -	\$ 30,000	
Deferred revenue	\$ -	\$ 100,000	
	<u>\$ -</u>	<u>\$ 130,000</u>	
Net assets			
Invested in property and equipment	\$ -	\$ 10,000	
<b>Available</b>	<b>\$ 157,000</b>	<b>\$ 31,500</b>	Note the great difference in the net position of the organization
	<u>\$ 157,000</u>	<u>\$ 41,500</u>	
	<u>\$ 157,000</u>	<u>\$ 171,500</u>	

## Taxation issues


One of the most important taxation issues to be aware of is that, despite broad beliefs otherwise, not-for-profit organizations are allowed, under CRA taxation rules, to generate a reasonable amount of surplus each year. Although there is no fixed rule enshrined in the tax law on this subject, it is generally accepted that a not-for-profit may follow the industry accepted principle of accumulating three to six months worth of committed operating expenses. It becomes then an issue for how the organization manages and reports out on those surpluses so that donors and partners do not assume the organization has more than it needs to operate.


A second critical taxation issue deals with disbursement quotas, which are very complicated formulas that must be applied to the disbursement of charitable gifts. In a nutshell, 80% of an organization's previous year's gifts must be expended by the end of the fiscal year. For organizations that earn capital assets, such as foundations and organizations that have endowments, 3.5% of the capital must be spent each year. Determining disbursement quotas is the job of your accountant, bookkeeper or treasurer, who should be aware of new changes to the legislation of disbursement quotas. The Canada Revenue Agency recently reported changes in Newsletter #27, the text of which follows:


**Summary:** The definition of “**enduring property**” applies for the purpose of the definition “disbursement quota” and applies to fiscal periods that begin after March 22, 2004. Gifts of enduring property are generally excluded from the charity's disbursement quota in the year they are received. However, the charity must consider these gifts when calculating the average value of property for its 3.5% disbursement quota requirement. When the charity spends or transfers some or all of the enduring property, 80% of the amount spent or 100% of the amount transferred must be included when calculating the disbursement quota requirement.

Transfers from registered charities to charitable organizations were previously exempt from the recipient charitable organization's disbursement quota. Under the new disbursement quota rules, there are three types of property transfers between charities: specified gifts, enduring property and other gifts, which are each treated differently.

Although the issue of taxation is partially covered in the Legal Handbook, it is important to note that taxation ties in with accounting from the perspective of the annual filing of your organization's financial statements to the Canada Revenue Agency (CRA).

This symbol  indicates a live weblink that can be found on the CDRom version of this handbook.

 The Canada Revenue Agency has a [Disbursement Quota worksheet](#) at their website which is designed to help a charity track its capital gains, determine if it has met its disbursement quota for the fiscal period, estimate its disbursement quota for the next fiscal period and track its excesses and shortfalls.

 Any charity that wishes to reduce its disbursement quota for a particular fiscal year can do so by applying to CRA using the [Application to Reduce Disbursement Quota](#) form.

## Notes and disclosures

Notes and disclosures form an important part of financial statements and help the reader understand the story behind the numbers, and of anything unusual or important to understand. Notes will cover off issues like any deviation from GAAP, any significant changes to accounting practices (like changes to depreciation), any restatements that have been made to the finances, and identify any pending events which may not yet have had an impact on the financial position of the organization. Disclosures are required by GAAP to ensure the readers of your financial statements have a complete picture of the financial standing of the organization.

The following are examples of Notes and Disclosures that are commonly used in not-for-profit financial reporting.

### Contingent Liability (sample text)

The not-for-profit organization and certain of its employees contribute to the Municipal Pension Plan, a plan with more than 101,000 active contributors from over 640 employers which is administered by the Superannuation Commission of the Province of British Columbia. This Plan has reported a large unfunded actuarial liability of \$547 million as at its latest complete actuarial valuation at December 31, 1997. The actuarial valuation as at December 31, 2000 is pending. The not-for-profit organization contributes to this Plan for less than 40 of its employees and, as such, represents a very small component of the total liability. The actuary does not attribute portions of the unfunded liability to individual employers. Contributions to the Plan by the not-for-profit organization are expensed in the year when payments are made.

### Commitment Note (sample text)

The not-for-profit organization is party to lease agreements for equipment and office and classroom space for which minimum lease payments over the duration of the leases are approximately as follows:

	Premise 1	Premise 2	Total
Year ended March 31, 2003	\$ 223,403	\$ 93,254	\$ 316,657
Year ended March 31, 2004	204,153	93,254	297,407
Year ended March 31, 2005	205,644	93,254	298,898
Year ended March 31, 2006	197,184	93,254	290,438
Year ended March 31, 2007	192,875	93,254	286,129
Year ended March 31, 2008	48,219	77,711	125,930
			<u>\$1,615,459</u>

It is not uncommon to find the most important information in the notes and disclosures because it provides more clarity to the numbers and more details on items where there is no numerical disclosure.

## Required and optional disclosures

“**Commitments**” is the disclosure of contractual and other commitments that will require resources from the org to pay. Best example is long term rental agreements.

“**Contingencies**” are events, the outcomes of which are not yet known, which may create a future outflow of resources. The best example of a situation that would require a contingency note would be a lawsuit. In the notes and disclosures you must disclose the potential that you may have to pay the lawsuit.

**Optional disclosures** can be anything factual that you want to capture in the notes. This could be more detail on certain items in the financial statement. The notes should only reflect items on your organization’s financial statement, and should not include notes that discuss future planning or direction (these should be captured in your annual plan).

Whenever GAAP allows for more than one way of accounting for an item in the financial statements, you have to disclose which method you’ve chosen.

## Summary of Significant Accounting Policies (sample text)

The significant accounting policies are required disclosure in the financial statements. Disclosure is required whenever there are two or more acceptable accounting treatments for the related item. The financial statements must disclose which treatment was selected so that the reader can understand the approaches taken.

Long-term are carried at cost. The carrying value may be reduced if, in the opinion of management, there is a permanent impairment in value.

Capital assets are recorded at cost with amortization provided on the straight line basis over three years. Additions in the year are amortized on a pro-rated basis over the number of months owned.

The use of certain capital assets subsequent to completion of funded programs is determined by the funders. Such assets are not capitalized.

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. Unrestricted contributions are recognized as revenue when received or receivable if the amount to be received can be reasonably estimated and

GAAP will dictate any required disclosures which tend to be in the areas of accounting policies, commitments and contingencies.

## Long-term investments

## Capital assets

## Revenue Recognition

collection is reasonably assured.

Unrestricted investment income is recognized as revenue when earned.

Cash and cash equivalents consist of cash on hand, bank balances less outstanding cheques or investments in money market instruments with maturities of three months or less.

The Society's financial instruments consist of cash, short-term deposits, grants receivable, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and demand loans. Unless otherwise noted, it is management's opinion that the Society is not exposed to significant interest, currency or credit risk arising from these financial instruments. The fair values of these financial instruments approximate their carrying values, unless otherwise noted.

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 differ from management's best estimates as additional information becomes available in the future.

## Cash and Cash Equivalents

## Financial Instruments

## Use of Estimates

## ***Notice to Readers, Review Engagements and Audits***

**Notice to readers** are the least amount of work for an accountant as the financial statements associated with a Notice to readers do not have to be prepared in accordance with GAAP, don't need disclosures, and the accountant does not do any work to verify the numbers that the not-for-profit has provided him or her. The accountant simply takes the information that is provided and arranges the numbers in a logical way. The only responsibility that the accountant has is that if he or she knows, for a fact, that numbers provided by the not-for-profit are untrue, that accountant must not prepare the Notice to readers. A Notice to readers does not add value, and is done to appease management or funders. Since the Notice to readers is presented on an accounting firm's letterhead, it has an unwarranted credibility.

**Review engagements** are a little more reliable than a Notice to readers in that the financial statement must be prepared in accordance with GAAP, so it will have complete notes and disclosures. The accountant does a plausibility review, which means they ask questions of staff about the differences in expenses from

There are only three types of reports an external accountant can give: notice to readers, review engagements and audits.

In terms of costs, a Notice to reader will typically cost between \$1000 and \$5000 depending on the type and size of organization.

year to year and the reasonability of plans for future operations. The accountant will do significant analysis and engage in detailed discussion but will not check back to receipts, bank account deposits/withdrawals, contracts or any other documents. They simply take the word of management as long as it's plausible.

An experienced accountant will make a good assessment of the plausibility of the information he or she is provided. Review engagement is useful when readers are fairly close to organization since they'll know what's going on. Review engagements are used where there is no contractual requirement for an audit by funders or other financiers. A review engagement looks, on the surface, exactly like an audited statement, the difference between the two is that the review engagement does not have an auditor's statement.

**Audits** are the highest form of assurance that an external accountant can provide: it will cover everything in the review engagement but it goes an extra step to verify figures with supporting documentation. Audits are important when there's a diverse group of members and/or funders being reported to. Some incorporating documents require an organization to have regular audits.

In British Columbia in particular, a lot of not-for-profits are not aware if they are a reporting or non-reporting society or not. In most cases, this is decided when the constitution and bylaws organization are established. In other cases, the registrar can make that decision if he or she feels that the NPO will be large and touch a lot of people, in which case the decision will typically be to make it a reporting society.

Sometimes funders will ask for an audit without fully understanding the depth and cost of creating such a document. It's certainly recommended that small organizations, or organizations that are being asked for an audit for a small grant, talk to the funder to determine if a review engagement would be satisfactory. In some situations it is in the interest of an NPO to move from a Review engagement to an Audit, such as when they decide to launch a large capital campaign to show potential donors that the organization's money is being spent wisely.

### **Clean versus qualified audits**

A clean audit is one in which the auditor has no comments about the financial situation of the organization that has been audited.

A qualified audit happens when an auditor finds issues or problems, or has concerns with the organization that has been audited.

The variability in cost for a Review engagement is even greater, between \$5000 and \$20,000, due to the time in writing notes and disclosures which can vary dramatically from one organization to another.

The cost of an audit can range from \$7500 for the smallest organization, and can go up to several hundred thousand dollars for a large organization (a university, for example).

It's important to realize that organizations can keep their financial reporting costs down by doing a lot of the financial statement preparation in advance of hiring an accountant.

In effect, the auditor qualifies his or her opinion about the financial situation of the organization by quantifying any concerns they have.

For instance, an auditor would qualify audit if the organization under review does not follow GAAP when accounting for employee benefits. The auditor's report would indicate and quantify the amount of unaccounted employee benefits and what the effect of those benefits is on the financial statements, had they been appropriately counted.

There are also less critical examples of an auditor qualifying an auditor. The common one for not-for-profits is related to the completeness of donations. If an NPO does any door-to-door fundraising, for example, it is impossible to verify that every dollar that has been donated to the organization as cash to a volunteer (or even staff) canvasser, has actually been given to the organization. In this situation the accountant will qualify the audit with a comment that indicates that he or she is unable to verify the completeness of donations. This is typically reported as a qualification about being unable to verify "loose collections." Loose collection is that cash handed over in a canvass: it is different than the transfer of dollars by cheque or pre-approved payment, which generates a paper trail.

A qualified audit is not always bad news, but it does signal to readers that some corrections need to be made to the way an organization manages its funds.

### ***Putting out tenders for accounting services***

NPOs are very different from corporate and for-profit organizations. Many firms will say that they have extensive experience working with NPOs – check their references and look for a firm that has experience dealing with organizations of a similar size. It can also be beneficial to find an accountant that understands the type of fundraising your NPO engages in and the issue area your organization works in.

Good governance suggests that you review your accounting professional every three to five years. You should review your experience working with that accountant: have they done a good job? Are they available to answer your questions throughout the year even when they're not actively auditing your organization? Have they met deadlines? Do they offer good solutions to your day-to-day accounting needs? And, do they identify ways for you to save money on the audit or review by doing some of the preparation work yourself?

When looking for an auditor or reviewer, be sure to hire an accountant who has a good deal of experience with your type of organization: not-for-profit, charity, co-operative or social enterprise.

## 2. Financial Statements

### ***Importance of quality, timely and reliable financial statements***

For organizations that may make hiring (and layoff) decisions about staff, depending on the health of funded programs, having timely and accurate financial statements is an important forecasting and decision-making tool. Those financial statements will also provide indicators about when you might need to approach your financial partner (bank or credit union) to seek lines of credit or operating loans to help you through skinny times. And different individuals in the organization require different information to make different kinds of decisions.

- The management team will need a detailed departmental focus on the organization so they can make precise decisions that may affect only one part of the organization.
- What the Board of Directors needs is a summarized, overall viewpoint of where the organization is, but highlighting the different project departments as well as areas where there are issues.
- Program partners will need information on the project they're supporting. If the partner is a funder, they will be concerned not just with the program they're funding but the 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 something like 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, will be 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.

The financial statements are going to be used for decision-making purposes, so the more accurate and timely, the better the decisions can be made.

## **Statement of Financial Position**

The Statement of Financial Position is simply a snapshot of an organization's assets and liabilities *as of a particular day*.

The current\*, appropriate way to calculate the value of your assets is to present them using what is called historical cost basis, which is what you paid for them, and segregated between current and non-current assets. Current assets are those items that are liquid cash resources or will be received within one year.

In addition to your assets, liabilities also have to be disclosed on your Statement of Financial Position. Like liabilities, these must be segregated between current and non-current.

The recording of assets and liabilities in not-for-profit organizations is one area that 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 NPOs this difference is called net assets, and it is 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 but the Board can choose to change that purpose if they desire.
- Available – these assets are considered “free and clear” money.

The reason these distinctions were developed is because many not-for-profit organizations were creating funds (with the intention of naming those funds as something other than “surplus” which might have scared off donors); the funds were being represented as quasi-liabilities, but in fact are assets but are definitely not freely available surpluses.

\* The Canadian Institute of Chartered Accountants is developing new Financial Instrument Rules that will change the way in which financial assets will be recorded in future, from historical cost basis to fair market value.

See next page for a sample Consolidated Statement of Financial Position

**Sample Statement 1**  
**Consolidated Statement of Financial Position**

<b>December 31</b>	<b>General Fund</b>	<b>Restricted Project Fund</b>	<b>Capital Asset Fund</b>	<b>Reserve Fund</b>	<b>2005</b>	<b>2004</b>
<b>Current Assets</b>						
Cash	\$ 204,348	\$ 2,913,721	\$ 611,782	\$ 1,133,803	\$ 4,863,654	\$ 4,159,047
Short term investments (Note 2)	-	-	285,202	1,500,214	1,785,416	235,050
Accounts receivable	542,054	122,928	3,224,207	-	3,889,189	2,103,557
Inventories	611,231	-	-	-	611,231	622,235
Prepaid expenses	321,399	831	344	-	379,128	277,436
Current portion of Capital Campaign pledges receivable (Note 3)	-	-	520,952	-	520,952	433,836
	<b>1,679,032</b>	<b>3,037,480</b>	<b>4,642,487</b>	<b>2,634,017</b>	<b>11,993,016</b>	<b>7,831,161</b>
Capital Campaign pledges receivable (Note 3)	-	-	1,540,000	-	1,540,000	1,180,561
Investments (Notes 2 and 12)	-	-	1,109,029	-	1,109,029	1,148,088
Capital assets (Note 4)	-	-	13,067,247	-	13,067,247	11,703,158
Capital assets in progress (Note 5)	-	-	7,996,599	-	7,996,599	2,129,322
	<b>\$ 1,679,032</b>	<b>\$ 3,037,480</b>	<b>\$ 28,355,362</b>	<b>\$ 2,634,017</b>	<b>\$ 35,705,891</b>	<b>\$ 23,992,290</b>
<b>Current Liabilities</b>						
Accounts payable	\$ 1,802,260	\$ 299,003	\$ 1,564,573	\$ -	\$ 3,665,836	\$ 2,210,502
Deferred revenue	271,720	-	-	-	271,720	306,650
Current portion of loans payable (Note 7)	-	-	113,660	-	113,660	110,857
Current portion of lease obligation	-	-	-	-	-	15,623
	2,073,980	299,003	1,678,233	-	4,051,216	2,643,632
Loans payable (Note 7)	-	-	5,511,803	-	5,511,803	1,625,462
	2,073,980	299,003	7,190,036	-	9,563,019	4,269,094
<b>Fund balances</b>						
Externally restricted net assets (Notes 8 and 12)	-	2,738,477	3,830,271	-	6,568,748	4,057,449
Net assets invested in capital assets	-	-	15,438,384	-	15,438,384	12,080,538
Board designated net assets (Note 9)	-	-	1,896,671	2,634,017	4,530,688	3,972,359
Unrestricted net assets	(394,948)	-	-	-	(394,948)	(387,150)
	(394,948)	2,738,477	21,165,326	2,634,017	26,142,872	19,723,196
	<b>\$ 1,679,032</b>	<b>\$ 3,037,480</b>	<b>\$ 28,355,362</b>	<b>\$ 2,634,017</b>	<b>\$ 35,705,891</b>	<b>\$ 23,992,290</b>

## ***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. 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.

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

See next page for a sample Statement of Operations

## ***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 year to year comparison. Likely the most interesting aspect of a statement of changes in net assets for Board and management will be the comparison between the opening and closing balance in each net asset category.

See next page for a sample Statement of Changes in Net Assets

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. The following statement shows the Changes in Net Assets information combined with the Statement of Operations. It is the last three lines of this statement which highlight the changes in Net Assets.

**Sample Statement 1**  
**Consolidated Statement of Operations and Changes in Fund Balances**

For the year ended December 31	General Fund	Restricted Project Fund	Capital Asset Fund	Reserve Fund	2005	2004
<b>Revenues</b>						
Programs	\$ 7,942,103	\$ -	\$ -	\$ -	\$ 7,942,103	\$ 7,437,699
Membership dues	1,057,340	-	-	-	1,057,340	957,225
Retail sales	4,732,909	-	-	-	4,732,909	4,148,316
Groups and programs	1,182,944	87,824	-	-	1,270,768	1,222,268
Capital Campaign pledges and donations (Note 3)	-	-	1,353,117	-	1,353,117	2,000,500
Grants and donations - restricted	372,699	3,346,477	5,525,715	-	9,244,891	5,841,749
Grants and donations - unrestricted	631,098	-	-	-	631,098	472,816
Interest and sundry	595,585	-	81,093	67,059	743,737	555,310
	<u>16,514,678</u>	<u>3,434,301</u>	<u>6,959,925</u>	<u>67,059</u>	<u>26,975,963</u>	<u>22,635,883</u>
<b>Expenses</b>						
Program costs	997,044	-	-	-	997,044	840,573
Retail operations	2,584,223	-	-	-	2,584,223	2,402,220
Educational programs	1,228,538	759,332	-	-	1,987,870	1,774,265
Marketing and development	1,959,153	-	-	-	1,959,153	1,866,283
Facility operations	2,962,407	-	-	-	2,962,407	2,965,261
Client care	2,413,125	-	-	-	2,413,125	1,976,687
Research	569,933	2,187,541	-	-	2,757,474	2,463,960
General administration	2,507,573	350,895	540	-	2,859,008	2,266,719
Interest on long-term debt	-	-	217,411	-	217,411	53,531
Amortization of capital assets	-	-	1,818,574	-	1,818,574	1,526,269
	<u>15,221,996</u>	<u>3,297,768</u>	<u>2,036,525</u>	<u>-</u>	<u>20,556,289</u>	<u>18,135,768</u>
Revenue over expenses for the year (Note 13)	1,292,682	136,533	4,923,400	67,059	6,419,674	4,500,115
Interfund transfers (Note 14)	(1,300,482)	-	1,139,764	160,718	-	-
Fund balances, beginning of year	(387,148)	2,601,944	15,102,162	2,406,240	19,723,198	15,223,081
Fund balances, end of year	\$ (394,948)	\$ 2,738,477	\$ 21,165,326	\$ 2,634,017	\$ 26,142,872	\$ 19,723,196

## 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. The only element that will be of value to review are the subtotals in the three subsections: operating activities, investing activities and financing activities.

### Sample Statement 1 Consolidated Statement of Cash Flows

<b>For the year ended December 31</b>	<b>2005</b>	<b>2004</b>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Revenue (under) over expenses for the year	\$ 6,419,674	4,500,115
Non cash item: Amortization	1,818,574	1,526,269
Changes in non-cash operating balances	(1,949,728)	26,297
	<u>6,288,520</u>	<u>6,052,681</u>
<b>Investing activities</b>		
Purchase of capital assets	(9,049,938)	(2,881,907)
Disposal of investments	39,059	31,887
	<u>(9,010,879)</u>	<u>(2,850,020)</u>
<b>Financing activities</b>		
Issue of long-term debt	4,000,000	-
Repayment of long-term debt	(126,479)	(330,721)
Change in capital donations receivable for the year	(446,555)	(725,000)
	<u>3,426,966</u>	<u>(1,055,721)</u>
<b>Increase in cash during the year</b>	704,607	2,146,940
<b>Cash and equivalents, beginning of year</b>	<u>4,159,047</u>	<u>2,012,107</u>
<b>Cash and equivalents, end of year</b>	<b>\$ 4,863,654</b>	<b>4,159,047</b>
<b>Represented by</b>		
General fund	\$ 204,348	85,870
Restricted funds	4,659,306	4,073,177
	<u>\$ 4,863,654</u>	<u>4,159,047</u>

## **Cash flow planning**

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### **Preparing a cash flow**

A cash flow is a forecast of when you expect to receive cash from your activities, or sales, and when you expect to pay your bills. It is not, and should not be confused with, an income statement. A cash flow is not an estimate of your revenues and expenses (that is a budget); rather, it is an estimate of when the money associated with those activities, or sales (etc) will be received and when the money involved in paying for expenses will be paid.

### **Why do a cash flow?**

Too often organizations only do a cash flow in their heads. Putting the cash on paper will give you the following:

1. A format for planning the most effective use of your cash (cash management).
2. A schedule of anticipated cash receipts (follow through to see that you achieve it).
3. A schedule of priorities for the payment of accounts.
4. A measure of the significance of unexpected changes in circumstances, i.e., reduction of sales, fundraising goals not achieved, tight money situations, etc.
5. A list, on paper, of all the bill paying details which have been running around in your head, keeping you awake nights. A cash flow is not an instant cure for sleeplessness, but it certainly helps. It also clears your mind for more productive thinking.
6. An estimate of the money you need to borrow in order to finance your day-to-day operations. This is perhaps the most important aspect of a completed cash flow projection.
7. An outline to show you and a lender that you have sufficient cash to make loan payment is you are planning to borrow money on a term basis.

### **How often**

Cash flow planning should be a continuous activity, although it must be completely redone at least once a year for you to have a clear picture of additional cash requirements. Most lines of credit are renewed annually, by a financial institution. The cash flow projection will assist you in making an effective presentation to your lender.

A cash flow planning document is a critical tool for an organization's management team to determine ebbs and flows in cash, and to plan accordingly how to meet payroll and other regular obligations of the organization.

Effective cash management is essential to survival and sustainability. Don't leave cash inflow and outflow to luck and pressure. You will lose.

Don't put the cash flow away and forget it. For example, if you don't meet your fundraising objective or you have a sudden unexpected payment to make, take the cash flow out and work through it again. You will be able to see the effect of the change on your cash position and can logically illustrate any revised loan requirements to your lender.

### **Where to start**

The first step in preparing a cash flow is to estimate revenue on a monthly basis. Revenue from previous years can be used to forecast revenue for the coming year. There are many yardsticks by which an organization can estimate its sales. A relatively conservative or low forecast can be used to determine the financial results of bad times. An optimistic forecast will show the strain on working capital that may result from better than expected operations. Finally, the most probable revenue forecast at the centre remains the anchor point about which plans are made.

Note: when preparing a cash flow, the purpose is to forecast cash receipts and to schedule payments, and to forecast the use of operating funds (line of credit) when necessary from the bank. This line of credit is arranged with the bank in advance (usually annually).

Estimate what amount of your revenues will be cash and what amount will be credit. If last year's revenues were 10% cash and 90% credit, and you do not plan to change your credit policies, chances are that the same proportions will occur again this year. If you receive funds on credit (particularly true for social enterprises), take into account when you can expect to collect the accounts receivable.

The next step is to plan for accounts payable on a monthly basis, according to your revenue and sales projections. For example, if you pay your invoices on a 30-day basis, then the cash expenditures for January's purchases will be made in February. If you can obtain trade credit for longer terms, then cash outlays can be further delayed.

### **Cash flow worksheet**

Now that total cash collections and total cash payments on goods purchased have been estimated, use the cash flow worksheet to list all cash transactions for the month. Remember: only list the actual cash you are expecting to receive or spend in the appropriate monthly column.

The cash flow forecast illustrates the need and timing for money. It also illustrates when cash receipts will reduce or eliminate the need.

## Using the cash flow worksheet

It is important that the cash flow is completed on an ongoing basis and is revised as your situation changes. Using the excel sheet on the CDROM is very useful for this purpose (only two of twelve months are set out in the workbook; the CDROM includes twelve months of cash flow planning). After each month has been completed, put the actual cash flow figures next to the planned figures and compare them. If the planned figures vary considerably with the actual, it may be necessary to revise the figures for succeeding months. In extreme situations, it may be necessary to rethink the particular aspects of the organization's operations.

A cash flow assists in financial planning, inventory purchases and formulating credit and collection policies. It also serves as an early indicator when expenses are getting out of line. It is one of the most important tools a manager or Executive Director has to control her or his organization.



### 3. Contributions

#### *Distinguishing contributions from other types of revenue*

In business, revenue is the amount of money that a company actually receives from its activities, mostly from sales of products and/or services to customers. In not-for-profits, revenue often includes fees for services, investment income and other reciprocal income. Regardless of the type of revenue, there is always a direct exchange for the money. The person or entity providing the money to the NPO receives something in exchange for the money they have given the NPO.

The key difference between a contribution and any other type of revenue is that contributions reflect a one-sided relationship: someone gives your organization money or a gift-in-kind with no expectation of anything in return. Contribution categories typically include grants, donations, capital assets, materials and services for which the person or entity providing the contribution receive no personal, direct benefit from making that contribution.

There are three types of Contributions: restricted, unrestricted and endowment.

- **Restricted contribution:** the contributor gives your organization money with very clear direction for how that money is to be expended. For instance, to build a shelter, or to provide hot lunches to kids in inner city schools.
- **Unrestricted contribution:** the contributor gives your organization money and says that you can use the money in any way that you see fit. Unrestricted contributions imply a high level of trust in an organization by the contributor that his or her money will be spent wisely.
- **Endowment contribution:** this is a special kind of restricted contribution in which the gift is kept in perpetuity and the receiving NPO draws on the investment earnings only.

There are three types of contributions:

1. restricted
2. unrestricted
3. endowment.

## ***Deferral versus restricted fund accounting method***

NPOs have the option of using the deferral method of accounting or the restricted fund method. The results of using one over the other can be quite dramatic.

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 your funders that is actually quite different 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.

Methods of accounting are another place where not-for-profit organizations differ from for-profit enterprises.

An example of how the deferral method of accounting creates a different statement than the restricted method is on the following three pages.

## Statement of Financial Position, Year One

### Deferral

Cash	\$ 450,000
Accounts receivable	<u>\$ 70,000</u>
	\$ 520,000
Capital Assets	<u>\$ 65,000</u>
	<b>\$ 585,000</b>
Accounts Payable	\$ 73,000
Deferred Revenue	<u>\$ 270,000</u>
	<b>\$ 343,000</b>
Net Assets	
Invested in capital assets	\$ 65,000
Program fund	\$ -
Net assets available	<u>\$ 177,000</u>
	<b>\$ 242,000</b>
	<b>\$ 585,000</b>

### Restricted Fund

Cash	\$ 450,000
Accounts receivable	<u>\$ 70,000</u>
	\$ 520,000
Capital Assets	<u>\$ 65,000</u>
	<b>\$ 585,000</b>
Accounts Payable	\$ 73,000
Deferred Revenue	<u>\$ -</u>
	<b>\$ 73,000</b>
Net Assets	
Invested in capital assets	\$ 65,000
Program fund	\$ 265,000
Net assets available	<u>\$ 182,000</u>
	<b>\$ 512,000</b>
	<b>\$ 585,000</b>

## Statement of Operations, Year One

### Deferral

Revenues	
Donations	\$ 140,000
Grants	<u>\$ 30,000</u>
	<b>\$ 170,000</b>
Expenses	
Payroll	\$ 100,000
Office	\$ 25,000
Program delivery	<u>\$ 35,000</u>
	<b>\$ 160,000</b>
Excess of revenue over expenses	\$ 10,000
Net assets available, beginning of year	<u>\$ 167,000</u>
Net assets available, end of year	<b>\$ 177,000</b>

### Reconciliation schedule for funders

Total grants received	\$ 300,000
Portion deferred	<u>\$ (270,000)</u>
Net grant revenue reported	<b>\$ 30,000</b>

### Restricted Fund

	General Fund	Program Fund
Revenues		
Donations	\$ 140,000	\$ -
Grants	<u>\$ -</u>	<u>\$ 300,000</u>
	<b>\$ 140,000</b>	<b>\$ 300,000</b>
Expenses		
Payroll	\$ 100,000	
Office	\$ 25,000	
Program delivery	<u>\$ -</u>	<u>\$ 35,000</u>
	<b>\$ 125,000</b>	<b>\$ 35,000</b>
Excess of revenue over expenses	\$ 15,000	\$ 265,000
Net assets available, beginning of year	<u>\$ 167,000</u>	<u>\$ -</u>
Net assets available, end of year	<b>\$ 182,000</b>	<b>\$ 265,000</b>

(No reconciliation schedule required)

## Statement of Financial Position, Year Two

### Deferral

Cash	\$ 275,000
Accounts receivable	<u>\$ 70,000</u>
	\$ 345,000
Capital Assets	<u>\$ 65,000</u>
	<b>\$ 410,000</b>
Accounts Payable	\$ 73,000
Deferred Revenue	<u>\$ 60,000</u>
	<b>\$ 133,000</b>
Net Assets	
Invested in capital assets	\$ 65,000
Program fund	\$ -
Net assets available	<u>\$ 212,000</u>
	<u>\$ 277,000</u>
	<b>\$ 410,000</b>

### Restricted Fund

Cash	\$ 275,000
Accounts receivable	<u>\$ 70,000</u>
	\$ 345,000
Capital Assets	<u>\$ 65,000</u>
	<b>\$ 410,000</b>
Accounts Payable	\$ 73,000
Deferred Revenue	<u>\$ -</u>
	<b>\$ 73,000</b>
Net Assets	
Invested in capital assets	\$ 65,000
Program fund	\$ 75,000
Net assets available	<u>\$ 197,000</u>
	<u>\$ 337,000</u>
	<b>\$ 410,000</b>

## Statement of Operations, Year Two

### Deferral

Revenues	
Donations	\$ 140,000
Grants	<u>\$ 210,000</u>
	<b>\$ 350,000</b>
Expenses	
Payroll	\$ 100,000
Office	\$ 25,000
Program delivery	<u>\$ 190,000</u>
	<b>\$ 315,000</b>
Excess of revenue over expenses	\$ 35,000
Net assets available, beginning of year	<u>\$ 177,000</u>
Net assets available, end of year	<b>\$ 212,000</b>

### Reconciliation schedule for funders

Total grants received	\$ -
Portion deferred	<u>\$ 210,000</u>
Net grant revenue reported	<b>\$ 210,000</b>

### Restricted Fund

	General Fund	Program Fund
Revenues		
Donations	\$ 140,000	\$ -
Grants	<u>\$ -</u>	<u>\$ -</u>
	<b>\$ 140,000</b>	<b>\$ -</b>
Expenses		
Payroll	\$ 100,000	
Office	\$ 25,000	
Program delivery	<u>\$ -</u>	<u>\$ 190,000</u>
	<b>\$ 125,000</b>	<b>\$ 190,000</b>
Excess of revenue over expenses	\$ 15,000	\$ (190,000)
Net assets available, beginning of year	<u>\$ 182,000</u>	<u>\$ 265,000</u>
Net assets available, end of year	<b>\$ 197,000</b>	<b>\$ 75,000</b>

(No reconciliation schedule required)

## Statement of Financial Position, Year Three

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

## Statement of Operations, Year Three

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

## ***Contributions receivable***

You basically have two ways in which you could decide to treat contributions receivable: you can record the contribution once it is pledged (that is before the cash is in your hands) or you could wait until you have actually deposited the cheque into your bank account.

If you choose the former method, it is important that you have confidence that the contributor will actually fulfill their commitment. If the contributor, for instance, is a funder that has indicated you will be receiving a grant, you'd have to make sure you meet all the criteria for receiving the grant before you book it. You should be as far along as having the contract signed before booking it.

Pledges receivable, on the other hand, are most often recorded on a cash basis because of the uncertainty around the ultimate collection of the pledges. Where this can become legitimately a grey area is when your organization has a solid history with the pledges. For instance, if you hold a pledge event every year and historically you collect between 78 and 80 percent of pledges, then you can book that percentage of the pledges before the cash is in-hand.

There is no GAPP policy on how contributions receivable should be treated. Your organization, however, should develop a clear accounting policy to ensure all contributions receivable are treated in the same way and that the method is clear to Board, management and your accountant.

## 4. Capital Assets

### *What is a capital asset?*

A capital asset is any item of economic value owned by an individual or corporation (including not-for-profits and charities), especially that which could be converted to cash. Examples are cash, securities, accounts receivable, inventory, office equipment, real estate, a car, and other property. On a balance sheet, assets are equal to the sum of liabilities, common stock, preferred stock, and retained earnings.

From an accounting perspective, assets are divided into the following categories:

- current assets (cash and other liquid items),
- long-term assets (real estate, plant, equipment),
- prepaid and deferred assets (expenditures for future costs such as insurance, rent, interest), and
- intangible assets (trademarks, patents, copyrights, goodwill).

### *Capitalization of capital assets*

Recording capital assets on the organization's statement of financial position provides financial statement users with information that is important for assessing the organization's ability to continue to achieve its service objectives.

Capital assets will be recognized on the Government's financial statements. They will be reported as part of non-financial assets. This will have no effect on the net public debt (gross liabilities less financial assets), but will have an impact on the accumulated deficit (net public debt less non-financial assets).

A capital asset should be recorded on the statement of financial position at cost. For a contributed capital asset, cost is considered to be fair value at the date of contribution. In unusual circumstances when fair value cannot be reasonably determined, the capital asset should be recorded at nominal value

The cost of a capital asset includes the purchase price and other acquisition costs such as installation costs, design and engineering fees, legal fees, survey costs, site preparation costs, freight charges, transportation, insurance costs and duties.

Recognition of contributions of capital assets helps provide an

Capital assets represent significant economic resources for many not-for-profit organizations.

Without capital assets, many organizations would not be able to provide the same level of service without incurring other expenses, such as rent.

understanding of the resources available to the organization and enables users of the financial statements to make comparisons with other organizations. A contributed capital asset would be recognized at its fair value at the date of contribution. Fair value of a contributed capital asset may be estimated using market or appraisal values. When an estimate of fair value cannot reasonably be made, both the capital asset and the related contribution would be recognized at nominal value.

A capital asset purchased by a not-for-profit organization at substantially below fair value would also be recognized at its fair value with the difference between the consideration paid for the capital asset and fair value reported as a contribution.

The cost of each capital asset acquired together as part of a single purchase (for example, the purchase of a building and land for a single amount) is determined by allocating the total price paid for all the capital assets acquired to each one on the basis of its relative fair value at the time of acquisition.

When, at the time of acquisition, a portion of the acquired capital asset is not intended for use, its cost and any costs of disposal, net of any estimated proceeds, are attributed to that portion of the acquired capital asset which is intended for use. For example, the cost of acquired land that includes a building which will be demolished comprises the cost of the acquired property and the cost of demolishing the building.

### ***Amortization / depreciation of capital assets***

Amortization should be recognized as an expense in the organization's statement of operations. Most capital assets have limited useful lives. This fact is recognized by amortizing capital assets in a rational and systematic manner over their useful lives. Recognizing amortization in this way allocates the cost of capital assets to the periods of service provided. Amortization expense is an important part of the cost associated with providing an organization's services, regardless of how the acquisition of capital assets is funded. Information about the organization's total costs is relevant to any assessment of the benefits the organization provides.

Different methods of amortizing a capital asset result in different patterns of expense recognition. The objective is to provide a rational and systematic basis for allocating the cost of a capital asset, less any residual value, over its useful life. A straight line method reflects a constant charge for the service as a function of time. A variable charge method reflects service as a function of

Not-for-profit organizations may receive substantial contributions of capital assets.

Amortization is an accounting concept referring to writing an expenditure off over its useful life rather than at that time it is acquired.

usage. Other methods may be appropriate in certain situations.

Residual value is the amount that the organization expects to be able to realize on disposal of a capital asset at the end of its useful life to the organization. In most cases, residual value would be negligible and would be ignored for the purpose of calculating amortization. However, when the organization expects the residual value of a capital asset to be significant, it would be factored into the calculation of amortization.

The useful life of a capital asset depends on its expected use by the organization. The fact that a capital asset is capable of lasting for a certain time period would not be justification for establishing a useful life for amortization purposes that is longer than the period over which the organization expects to be able to use the asset. Factors to be considered in estimating the useful life of a capital asset include expected future usage, effects of technological obsolescence, expected wear and tear from use or the passage of time, the maintenance program, and the condition of existing comparable items.

The amortization method and the estimate of the useful life of a capital asset should be reviewed on a regular basis. Significant events that may indicate a need to revise the amortization method or the estimate of the useful life of a capital asset include:

- a) a change in the extent the capital asset is used;
- b) a change in the manner in which the capital asset is used;
- c) removal of the capital asset from service for an extended period of time;
- d) physical damage;
- e) significant technological developments; and
- f) a change in the law or environment affecting the period of time over which the capital asset can be used.

### ***Depreciation of capital assets***

You generally can't deduct the entire cost of acquiring such an asset in the year you acquire it. Why not? Because one of the goals of accounting is to accurately measure an organization's gross revenues, expenses, and net revenue (surpluses) during a given period of time, usually a year. If an organization reduced one year's gross revenues by an expense deduction for the total cost of an item that will be used for several years (such as the purchase of new computers or a photocopier, for example), the result would be an understatement of earnings in the year the asset was purchased, and an overstatement of earnings during the following years.

Capital assets are subject to special treatment under the tax laws. True, but since non-profits are not subject to tax, this may not be relevant.

It follows that, for “capital assets” (assets that have a useful life of more than one year), the cost must be written off (that is, depreciated or amortized) over more than one year.

Theoretically, the cost of an asset should be deducted over the number of years that the asset will be used, according to the actual drop in value that the asset will suffer each year. At the end of each year, you could subtract all depreciation claimed to date from the cost of the asset, to arrive at the asset’s “book value,” which would be equal to its market value. At the end of the asset’s useful life for the business, any un-depreciated portion would represent the salvage value for which the asset could be sold.

Since the actual drop in value of each individual asset would be difficult and time-consuming to compute (if indeed it could be computed at all), accountants use a variety of conventions to approximate and standardize the depreciation process. Typically, computers are depreciated over two or three years, while furniture and equipment are depreciated over five years. Check with your accountant about their standard depreciation schedules.

### ***Leasing / borrowing / buying***

When it comes to buying equipment -- including everything from vans to computers, not-for-profit organizations have many of the same needs as a for-profit business. However, because not-for-profit organizations don’t have the same tax status as for-profits, different criteria may influence the way NPOs finance this equipment.

Leasing or renting can ease cash flow problems by spreading payments over months or years, but lease repayments can potentially be structured to match your pattern of income. And spreading out payments over time eases up ready cash for other needs, like monthly rent and payroll.

So should you choose a lease or rental purchase? Ask your accountant to analyze the costs and make the best recommendation for your needs. And consider pooling with other not-for-profits near you to share the costs of expensive items like copiers.

When you take out a lease, the company providing the lease remains the legal owner and the not-for-profit becomes responsible for monthly payments of the capital cost, depreciation and borrowing cost for that leased item. Lease arrangements in Canada are commonly held for big-ticket items like large photocopiers. It is important to analyze the contract life cost of the lease; you may be

When buying new equipment, not-for-profit organizations tend to think first about how much money they have on hand. There are, however, a number of other finance options available that can ease the burden of upfront purchasing.

### **Lease**

getting into a very expensive contractual agreement that costs you much more than the value of the service provided.

It is important to note that leasing arrangements may be considered by your accountants to transfer most of the risks and benefits of ownership to your organization. If so the lease is “capitalized” which means it is recorded as if you bought the asset and had to borrow to do so. This is a complex accounting area, but the point for our discussion here is that the leasing vs. buy decision should be made based on financial criteria, not on how it may improve the look of the financial statements.

If you use a commercial loan to acquire an asset, you may be entitled to depreciate the equipment right from the start. Borrowing from a credit union or bank may be cheaper than a lease agreement, and at the end of the loan period, you’ll own the asset (but it may have depreciated significantly). It may make sense to lease photocopiers, but borrow to buy buildings: copiers depreciate, buildings appreciate (in value).

The financier buys the goods and hires them back to you as the customer. You automatically own the asset at the end of the agreement. You can borrow up to 100 per cent of the equipment price. If you prefer, you can pay a deposit to reduce the extent of your borrowing. As you are building equity in the equipment with the payment of each instalment, you may want to consider hire purchase for goods with long lifespans and high resale value that you would prefer to own rather than replace.

Renting is a flexible way to keep up-to-date with new technologies with a short lifespan due to high obsolescence, such as computers and telephones.

**Borrow (to buy)**

**Commercial rental  
purchase (rent to own)**

**Equipment rental**

## 5. Accounting Best Practices

### *Accounting management*

This full in-house service has many benefits. Your accountant is right there, on-site, and able to provide a full range of accounting management services. The accountant can provide significant support to the management team. The accountant can be involved in strategic and budget planning exercises. And the accountant will always have his or her eye on ways to streamline accounting processes, and improve efficiencies in your operations.

In a small organization, where it doesn't make sense to have an accountant on salary, out-sourcing allows key staff to focus on "core competencies" as opposed to trying to be a Jack- or Jacqueline-of-all-trades. Tapping the expertise of contract service providers can actually lower accounting costs and improve productivity of staff bookkeepers. Some organizations will also hire contract staff to carry out their bookkeeping functions, as well as their accounting work; the right solution depends on the size of the organization, the complexity of the revenue streams and project reporting requirements.

### *Tools for managing your books*

No one software solution works well for every not-for-profit, and not every not-for-profit will need the many functions of a software package like ACCPAC. It is important to get good advice from an accountant who understands your needs before investing in software: don't buy more than you need, but do not buy too small a system that won't support growth.

One of the challenges of accounting software is the general inadequacy of the reporting function for management review purposes. Accounting software is easily used and understood by accountants, but translating accounting reports into management tools that can be read and understood by Executive Directors and Board members is more difficult. Ask other organizations of your size and with similar revenue and project structures what they use, and what they recommend.

Another consideration is how you integrate member and donor tracking, and pledge tracking, into your accounting software. CRM, or "customer relationship management," is a critical component of member and donor stewardship, but is often not well tracked by not-for-profits. When you are considering accounting software, ask how it links with any CRM tools you may be using, or may be considering.

Larger not-for-profit organizations often have their own accounting department or an accountant that works for them as an employee.

Smaller not-for-profits will generally contract out or "out-source" their accounting management.

There is a broad range of software applications for managing your books.

## ***Audit trails***

It is important that all events, including changes to correct errors, or make adjustments, are recorded and are transparent. At year end, your auditor or accountant will need to see the documentation to support entries made in your general ledger: from paper copies of receipts to the bank deposit slips to reversals of entries and corrections in your accounting software: all of these leave a trail that tells a story of why revenues or expenses were received or incurred.

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

## ***Checks and balances***

There are three basic types of checks and balances, or internal control:

- Operational controls pertain to the effectiveness and efficiency of an operation.
- Compliance controls refers to the ability of the organization to continue operations and the reputation of the entity in the marketplace.
- Financial controls concentrates on the reliability and integrity of the financial information.

Checks and balances are basically the internal controls that your organization puts in place to ensure the people and processes are working as they should be.

With increased public expectation for and attention on accountability, not-for-profits are urged to implement or re-evaluate their internal control structure. Internal controls are mechanisms that prevent errors from entering the process or detecting the errors once they have.

The following are things to consider when setting out to establish effective internal controls.

- Ensure your Board of Directors are engaged and informed since internal control starts with good governance
- Assess how to control the risk
- Focus on what is material and significant
- Focus on continual monitoring – not a one time shot
- Adopt best practices

More information about financial controls can be found in the Financial Fitness 101 handbook.

## ***Cash management***

### **Managing “loose” collections**

Cash funds are known as loose collections because they are unverifiable. If you receive a lot of funds in loose collections, you may end up with a qualification on your audit (if the auditor deems the size of the collections to be potentially material). There may be ways to minimize your exposure to qualifications; ask your auditor how you can introduce checks and balances into this aspect of your fundraising.

An example of loose collections are donation tins at a local retail store for coin collection. AN NPO can collect and count the \$71.18 that was collected through that tin, and deposit it to their bank account, but there is no way to prove to the auditor or accountant that \$73.18 was not actually in the tin, and that a tooney was lost between emptying the tin and putting the cash in the bank.

Another example of loose collections are canvassers who sell calendars at year-end for an NPO, door to door. There is simply no way to know if a canvasser collected more funds than he or she remitted (accidentally or purposefully).

### **Dual custody**

Dual custody is a process that requires two people in order to access cash at any given time by physically restricting the access to the cashbox or safe. The physical restriction is achieved through the use of two different keys given to two different people or groups to access the cash. When funds need to be accessed, the safe must be opened in dual custody; when the transaction is complete, the safe must be locked under dual custody. Change funds that are over \$10,000 must be kept in dual custody.

### ***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 enter agreements and contracts for the organization. Day-to-day, the rules are sometimes ignored or forgotten, in the interest of expediency or a lack of understanding of the delegated authorities. There are a number of practices, which can be developed as accounting policies, that an NPO can adopt to ensure rules are not overlooked.

Loose collections are those cash donations or collections you may take throughout the year that are difficult to support with documentation.

For examples of accounting policies that can help address or mitigate authority leaks, see the resource, Sample Statement 2, Summary of Significant Accounting Policies.

Most not-for-profits set up their bank accounts to require two signatures to authorize payment, or set up an amount above which, two signatures are required (ie, one signature for amounts up to \$2,000; two signatures above that). Many not-for-profits require two signatures on all amounts, and that one of those signatures be a Board signature on amounts about a set amount (ie, one staff signature and the treasurer's signature on amounts over \$10,000).

In order for this important control to be effective, it is important that both signing officers only sign the cheques once they have been completed and presented along with supporting documentation. There unfortunately is a common practice amongst not-for-profits where one of the signing authorities signs the cheques when they are still blank in order to "speed up payment process". This is simply not acceptable. Signing authorities should never sign blank 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 simply do not have the time to review each cheque against a signature card on file. NPOs 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.

In the same way that Boards may delegate certain signing authorities to staff, the Board may delegate contracting authority to staff, on leases and contracts. However, contracts may be signed inappropriately because the staff does not actually have the authority to enter into a certain contract. Photocopier leases are a good example: administrative staff or even Executive Directors may enter into and sign a five-year contract for a photocopier lease, with a monthly payment of \$600. Those staff may, however, have a signing limit of \$10,000. The contract they have signed has a "lifetime value" of \$36,000 (\$600 x 12 months x 5 years). The Board is ultimately responsible for these type of obligations of an organization, and in this example, the Board should have authorized the entering of this lease agreement, and signed the contract.

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 transaction. Therefore, the accounting staff should not be able to transfer funds out of the bank account, say to a service provider via online banking, without a second signature or action by another signer. Likewise, the accounting staff should not be allowed to initiate wire transfers, without supporting documentation signed by two authorized signers.

## **Signing authority on cheques**

## **Contract authority on leases and contracts**

## **Transfer authority at the Financial Institution and with wire services**

## 6. Human Resources

### *Payroll*

#### **Regular time, overtime, “per job” payments**

Regular time is the maximum number of hours that may be worked in a week by an employee. In most organizations, regular time for a full-time employee is between 35 and 40 hours per week.

Overtime, most commonly defined for a regular, full-time employee, is all hours worked in excess of either eight hours a day or 44 hours a week. Overtime hours are to be calculated both on a daily and on a weekly basis. The higher of the two numbers is overtime hours worked in the week. All employees, including those who are paid a weekly, monthly, or annual salary, must be paid overtime pay for overtime hours they work. Overtime must be paid at the rate of at least 1.5 times the employee’s regular wage rate. The sole exception applies where the overtime is accumulated under an overtime agreement.

Employees, who are paid exclusively by incentive pay such as commission, piecework or a similar method, have no established rate of pay. Therefore, for the purpose of calculating overtime entitlements the wage rate is deemed to be the minimum wage. If the incentive pay is less than what would have been earned applying the minimum wage, the employer must top up the incentive pay earnings.

If an employee is paid by a combination of salary and incentive pay, and the salary is greater than minimum wage, the salary establishes the hourly rate for the purpose of calculating overtime entitlements.

Per job payments are performed by contractors or consultants who will invoice the organization.

#### **Trends in employment (contracting, job sharing, sharing contractors)**

Large corporations want to be leaner and meaner. Rather than staff up, they’ll outsource functions. As large firms respond to tighter times by restructuring, they’ll continue to replace employees with contract workers.

Not-for-profit organizations, facing more and more challenges in finding ongoing, secure funding, are tending toward the same approach since, when the person doing the work is not on payroll,

The term payroll is often used to refer to the total amount of money paid to employees for a certain period. Payroll expenditures are subject to various federal and provincial regulations. The major components of most payroll systems include the payroll register, employees’ earning records, and payroll cheques

Self-employment, contracting, and consulting have changed the nature of work. We are becoming a nation of people freelancing their skills and talents.

it's easier to change or adapt the workforce to meet changing needs and resources of the organization.

Job sharing is simply the sharing of one full-time staff position by two staff members. The job sharing team shares the responsibilities of the job with each person working a portion of the time normally covered by one full-time position. In some cases the job share team will split the time on a 50-50 basis, and in other cases the ratio is different. It is important that an organization that chooses to allow job sharing ensure that the two sharers have time each week to meet during work hours to maintain continuity of the job. Of course, this overlap of time will have financial implications that must be considered and accounted for.

Job sharing is another trend that is being played with in both the private and not-for-profit sectors.


## ***Obligations to the government***

### **Payroll remittances for tax, EI, CPP, Workplace Safety**

As an employer, trustee, or payer, you are responsible for deducting Canada Pension Plan (CPP) contributions, Employment Insurance (EI) premiums and income tax from remuneration or other types of income you pay, remitting them to the Canadian government and reporting them on the applicable slips.

### **Employment Insurance**


You have to deduct EI premiums from your employees' insurable earnings on every dollar up to the yearly maximum, which changes from year to year. The government keeps the EI premium rates and maximums current on their website. As an employer, it's important that you not forget that your organization must also contribute 1.4 times the EI premium withheld for each employee.

 For more EI information go to the [CRA website](#).

### **Canada Pension Plan**

You have to deduct CPP contributions from an employee's remuneration if that employee:

- is 18 years or older, but younger than 70;
- is in pensionable employment during the year; and
- does not receive a CPP retirement or disability pension.

 The CRA website has more detailed information on [how to calculate CCP](#).

As an employer, you must also contribute the same amount of CPP that you deduct from your employees' remuneration.

## Payroll Deductions and Taxable Benefits

Two more areas that every not-for-profit organization should be quite familiar with and account for on financial statements are the impacts of payroll deductions and taxable benefits on the organization's financial standing or situation.

### Workplace Safety

It's essential that your organization provide all of your employees and contractors with a safe working environment. The areas that need to be evaluated are as follows:


- Emergency Preparedness at Work
- Worker Rights and Responsibilities
- Bullying in the Workplace
- Safety on the Job
- Workplace Hazards

You may be paying an insurance premium to a provincial office like "Worksafe" that will provide workers' compensation benefits in the case of an accident at work. Premiums are usually based on total payroll dollars, and different industries and services pay different premiums. Most not-for-profits will be risk-rated quite low, if their staff are generally working in offices.

### Remittance ceilings, adjustments for other taxes

If you are using accounting software with a payroll function or if you use a payroll service like ADP, the remittance ceiling will be noticed and deductions will stop. However, if you are a not-for-profit that is affiliated with another not-for-profit, and you share employees (that is, you have a non-charitable society and a federal charity that are inter-related, some of your employees work for both entities), your payroll program will not know if the combined remittances have hit the ceiling. The result will be over-deducting from your employees (they will receive the funds back in the next year, after they file their income taxes).

Employees can ask for different amounts of federal and provincial taxes to be taken from their payroll, if their domestic situation allows them to file with a spouse or common law partner, and there would be an overpayment of taxes based on combined filing but single deductions. Ask Revenue Canada for an Interpretation Bulletin on income tax deductions.

 The CRA is the best place for current and detailed information about these topics:

- T4001 – Employer's Guide – [Payroll Deductions and Remittances](#)
- T4130 – Employer's Guide – [Taxable Benefits](#)

There are ceilings on payroll remittances (EI, CPP), above which an employer should stop making payroll deductions on individual employee's payrolls.

## ***Holiday accrual***

### **Budgeting for earned holidays**

It's important that management and Board are aware of how many staff days have been accrued in holiday time since it can have a significant impact on operations if one or more employees have accrued several weeks of time away from the office. It's important for the Board to develop good policies around vacation time that are fair to both the employee and the health of the organization.

In the context of accounting, it's important to note that when an auditor, or external accountant sees that certain staff are not taking holidays, it raises a red flag since it can be an indication that that staff person is involved in some accounting fraud. For instance, an executive Director or bookkeeper who never takes holidays may be unable to leave the office since, if they do, the scam they are involved in would be noticed by whomever is taking on their job during their short-term absence.

### **Holiday Accrual Rate**

One standard way to determine holiday accrual is based simply on the work hours of each individual employee. For instance, the standard holiday accrual rate for a full-time employee is 8 hrs/holiday (that is, if they work full-time, the holiday is a fully-paid day for them). The holiday accrual rate for a part-time employee is often prorated based on the employee's percent of time (for example, if the employee works half-time, they get four hours of the holiday as paid time off, while an employee who works a four-day workweek would get six hours of the holiday as paid time off.) In most cases, an employee must be on pay status at least 50% to earn any holiday accrual.

### ***Planning for other benefits***

Other benefits to help attract and keep staff include more professional development opportunities, more holidays, transportation allowances, contributions to savings plans, and so on.

Although the wages line of your organization's financial statement does not reflect these bonuses, it is critical that any employee benefits that carry a long-term cost are accounted for on an actuarial basis. This can create a significant liability for the organization and there are complex accounting rules in this area. It is best to talk to your accountant about how to capture benefits on your financial statements.

Vacation time has to be recorded on an accrual basis, since your not-for-profit is setting up a liability in that time which will one day be claimed.

Holiday accrual rate is another area that should be included in a policy document.

Because NPOs often have trouble competing with the private sector for staff on a pure wage basis, sometimes other benefits can help level the playing field.

The CICA Handbook has very clear guidelines in section 3461, Employee future benefits.

## ***Planning for staff training and staff absence***

New staff will not be fully productive contributors as soon as they start. Your organization must allow for a reasonable ramp-up time for new staff to grasp their role and responsibilities. Proper training requires time which has a financial impact on the organization. The same thinking applies to retraining of staff who have been given new tasks or upgrading the skills of staff. Proper training is essential for maintained and increased productivity, and is a key factor in maintaining employee satisfaction, which leads to employee retention. And since keeping existing staff is usually more financially beneficial than having to replace them, the cost of staff training should be considered in this light.

Other situations you should account for that will affect your staffing and resources will be staff leaves, both anticipated and emergencies (sick leave, compassionate leave and jury duty).

It's vital to be strategic in your budgeting and planning for both staff training and staff absences.

## Additional Resources

### *Checklist to Assess Accounting Activities in Nonprofit Organizations*

Indicator	Meet	Needs Work	N/A
1. The organization follows accounting practices which conform to accepted standards.			
2. The organization has systems in place to provide the appropriate information needed by staff and Board to make sound financial decisions and to fulfill CRA requirements.			
3. The organization prepares timely financial statements including the Balance Sheet [or statement of financial position] and Statement of Revenue and Expenses [or statement of financial activities] which are clearly stated and useful for the Board and staff.			
4. The organization prepares financial statements on a budget versus actual and/or comparative basis to achieve a better understanding of their finances.			
5. The organization develops an annual comprehensive operating budget which includes costs for all programs, management and fundraising and all sources of funding. This budget is reviewed and approved by the Board of Directors.			
6. The organization monitors unit costs of programs and services through the documentation of staff time and direct expenses and use of a process for allocation of management and general and fundraising expenses.			
7. The organization prepares cash flow projections.			
8. The organization periodically forecasts year-end revenues and expenses to assist in making sound management decisions during the year.			
9. The organization reconciles all cash accounts monthly.			
10. The organization has a written fiscal policy and procedures manual and follows it.			
11. The organization has a written policy related to investments.			
12. Capital needs are reviewed at least annually and priorities established.			
13. The organization has established a plan identifying actions to take in the event of a reduction or loss in funding.			
14. The organization has established, or is actively trying to develop, a reserve of funds to cover at least three months of operating expenses.			
15. The organization reviews income annually to determine and report unrelated business income to the CRA.			
16. Training is made available for Board and appropriate staff on relevant accounting topics and all appropriate persons are encouraged to participate in various training opportunities.			

## Case Study – Workshop Activity

### Instructions:

On the following pages are the documents that form a complete financial statement package for a fictitious not-for-profit organization.

In your groups, review the financial statements attached. Be prepared to discuss the following questions:

- *What observations can you make about this organization and their accounting practices?*
- *Where do you see problems in their financial statements?*
- *What steps would you recommend this organization take in order to ensure their accounting practices improve?*

Appoint a spokesperson to report back to the larger group.

### Notes

**Troubled Society  
Financial Statements  
For the year ended March 31, 2006**

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**Auditors' Report**

**Financial Statements**

Statement of Financial Position

Statement of Changes in Net Assets

Statement of Operations

Statement of Cash Flows

Summary of Significant Accounting Policies

Notes to Financial Statements

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## Auditors' Report

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### To the Directors of Troubled Society

We have audited the Statement of Financial Position of Troubled Society as at March 31, 2006 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 were not able to determine whether adjustments might be necessary to revenues, expenses and deficiency of revenue over expenses and net assets.

In common with many charitable organizations, the Society 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 Society and we were not able to determine whether any adjustments might be necessary to revenue, deficiency of revenue over expenses, assets and Net Assets.

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 preceding paragraphs, these financial statements present fairly, in all material respects, the financial position of the Society as at March 31, 2006 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, 2006

**Troubled Society**  
**Statement of Financial Position**

**For the year ended March 31**

**2006**

**2005**

**Assets**

**Current**

Cash and short-term deposits (Note 1)	\$	<b>5,000</b>	\$	20,000
Accounts receivable		<b>20,000</b>		10,000
Prepaid rent		<b>2,000</b>		2,000
		<hr/>		<hr/>
		<b>27,000</b>		32,000

**Capital assets (Note 3)**

		<b>950</b>		-
		<hr/>		<hr/>
		<b>27,950</b>		32,000

**Liabilities**

**Current**

Accounts payable and accrued liabilities	\$	<b>50,000</b>	\$	7,000
Loan payable (Note 2)		<b>150,000</b>		50,000
Deferred revenue		<b>10,000</b>		50,000
		<hr/>		<hr/>
		<b>210,000</b>		107,000

**Net Assets**

Invested in capital assets		<b>950</b>		-
Available		<b>(183,000)</b>		(75,000)
		<hr/>		<hr/>
		<b>(182,050)</b>		(75,000)
		<hr/>		<hr/>
		<b>27,950</b>		32,000

Approved on behalf of the Board:

\_\_\_\_\_ Director

\_\_\_\_\_ Director

**Troubled Society**  
**Statement of Changes in Net Assets**

**For the year ended March 31, 2006**

	Invested in Capital Assets	Unrestricted	Total	
			2006	2005
<b>Balance</b> , beginning of year as previously stated	\$ -	\$ (8,217)	\$ (75,000)	\$ 20,000
Adjustment to prior period re: grant revenue (Note 6)	-	-	-	(10,000)
<b>As restated</b>	-	(8,217)	(75,000)	10,000
Deficiency of revenue over expenses	(50)	(107,000)	(107,050)	(85,000)
Purchase of capital assets	1,000	(1,000)	-	-
<b>Balance</b> , end of year	\$ 950	\$ (116,217)	\$ (182,050)	\$ (75,000)

**Troubled Society**  
**Statement of Operations**

**For the year ended March 31**

**2006**

**2005**

**Revenue**

Donations and fundraising	\$ 215,000	\$ 215,000
Fees and rentals	10,000	5,000
Training	3,000	100
Miscellaneous	30,000	-
Government grants	150,000	100,000
Interest	3,000	3,000
Administrative recoveries	3,000	3,000
	<u>414,000</u>	<u>326,100</u>

**Expenses**

Advertising and promotion	5,000	1,000
Amortization expense	50	-
Bad debt expense	25,000	5,000
Honourariums	10,000	7,000
Insurance	3,000	1,000
Interest charges	10,000	5,000
Office expense and janitorial	45,000	10,000
Rent	100,000	75,000
Salaries and benefits	316,000	299,100
Telephone and utilities	7,000	6,000
	<u>521,050</u>	<u>409,100</u>

<b>Deficiency of revenue over expenses</b>	<b>\$ (107,050)</b>	<b>\$ (83,000)</b>
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**Troubled Society**  
**Statement of Cash Flows**

**For the year ended March 31**

**2006**

**2005**

**Cash provided (used) by**

**Operating activities**

Operations		
Deficiency of revenue over expenses	\$ (107,050)	\$ (85,000)
Item not involving cash		
Amortization of capital assets	<u>50</u>	<u>-</u>
	<b>(107,000)</b>	<b>(85,000)</b>
Changes in non-cash working capital balances		
Accounts receivable	<b>(10,000)</b>	(12,000)
Accounts payable and accrued liabilities	<b>43,000</b>	7,000
Deferred revenue	<b>(40,000)</b>	<u>50,000</u>
	<b>(114,000)</b>	<b>(40,000)</b>

**Investing activities**

Acquisition of capital assets	<u><b>(1,000)</b></u>	<u>-</u>
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**Financing activity**

Increase in operating loan	<u><b>100,000</b></u>	<u>50,000</u>
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<b>Increase (decrease) in cash and short-term deposits for the year</b>	<b>(15,000)</b>	10,000
<b>Cash and short-term deposits, beginning of year</b>	<u><b>20,000</b></u>	<u>10,000</u>
<b>Cash and short-term deposits, end of year</b>	<u><b>\$ 5,000</b></u>	<u>\$ 20,000</u>

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## Troubled Society Summary of Significant Accounting Policies

**March 31, 2006**

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<b>General</b>	The Troubled Society ("the Society") is incorporated under the Society Act of British Columbia and operates throughout the province.
<b>Capital Assets</b>	Capital assets are recorded at cost and amortization is provided as follows:  Equipment                      - 10% straight line
<b>Revenue Recognition</b>	<p>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.</p> <p>Revenues and expenses relating to donor campaigns are deferred until completion of the campaign. Lottery proceeds are accounted for on a completed lottery basis.</p> <p>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.</p>
<b>Contributed Services</b>	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.
<b>Expense Recoveries</b>	Expense recoveries revenue includes administration costs charged to other organizations as well as charges to special projects carried out within the Society.
<b>Financial Instruments</b>	The Society's financial instruments consist of cash and short-term deposits, accounts receivable, accounts payable and accrued liabilities and loan payable. Unless otherwise noted, it is management's opinion that the Society is not exposed to significant interest, currency or credit risks arising from these financial instruments.
<b>Use of Estimates</b>	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.

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**Troubled Society**  
**Notes to Financial Statements**

**March 31, 2006**

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**1. Cash and Short-term Deposits**

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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 (2005 - \$20,000) earns interest at 4.45% (2003 - 4.15%) and matures on October 31, 2007.

**2. Loan Payable and Subsequent Event**

---

The Society has an operating loan due on November 9, 2007 which bears interest at 10.25%, calculated semi-annually and repaid by monthly principal payments of \$1,500 plus interest. The loan is collateralized by the \$20,000 term deposit (Note 1).

**3. Capital Assets**

			<u>2006</u>		<u>2005</u>	
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>		<u>Net Book Value</u>	
Office equipment	\$ 1,000	\$ 50	\$ 950	\$		-

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**4. Commitments**

---

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, 2009.

**5. Contingent Liabilities**

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.

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**6. 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.

## Self-assessment on Accounting Athletics - ANSWERS

**1. Select the statement which is most accurate:**

- The main difference between accounting for a not-for-profit organization and a for-profit corporation has to do with how to report funding that is received and passed on to other organizations.
- The main difference between accounting for a not-for-profit organization and a for-profit corporation is that not-for-profits cannot show a positive profit line and for-profits strive to show a positive profit line.
- Accounting practices used for not-for-profit organizations are very different from accounting practices used for for-profit corporations.

The correct answer is (a).

**2. True or False:** Generally Accepted Accounting Principles (GAAP) are mandated by law and are, for the most part, static rules that must be followed.

False.

**3. How much “profit” is generally acceptable on a not-for-profit’s balance sheet?**

- 10% of the revenue generated in the year being reported on
- 10% of the overall budget of the year being reported on
- Three to six months worth of committed operating expenses
- No amount. The balance sheet must not show a net surplus of income over expenses.

The correct answer is (c).

**4. True or False:** The Notes and Disclosures portion of an organization’s financial statements are of little importance compared to the actual numbers that are reported in the statements.

False.

**5. What are the three levels of reports an external accountant can prepare for a not-for-profit organization?**

**6. There are five basic financial statements used by organizations that are managing their finances well. Match each of these financial statements with their brief description:**

- Notice to reader
- Review engagement
- Audited statement

Financial Statement	Description
Financial Position	Snapshot of an organization’s assets and liabilities on a particular <i>day</i> .
Operations	Summary of revenues and expenses for a particular period, most often one year.
Changes in Net Assets	Summary of where money moved over the course of a year and is most useful when used to compare year-to-year data.
Cash Flows	Summary of the sources and use of cash in the organization.

See correct matches at left.

7. Contributions are unique to not-for-profit organizations. **Select all the types of contributions that a not-for-profit can report.**
- Personal
  - Restricted
  - Project
  - Unrestricted
  - Endowment
8. **True or False:** GAAP policies on how contributions receivable should be treated are very strict.
9. **Match the capital asset category with common examples that represent that type of asset.**

Capital Asset	Common Example
Current Asset	Cash and liquid items
Long-term Asset	Real estate, plant, equipment
Pre-paid and deferred Assets	Insurance, rent, interest
Intangible Assets	Trademarks, patents, copyrights, goodwill

10. There are three basic types of internal control that an organization should put in place to ensure people and processes are working as they should be. These **internal controls are:**
- Operational controls
  - Conduct controls
  - Financial controls
  - Compliance controls
  - Reporting controls

The correct answers are (b), (d) and (e)

False.

See correct matches at left.

The correct answers are (a), (c) and (d).

## **Case Study - Answers**

### **Comments on Troubled Society Financial Statements**

Look for numbers [1] to [39] on the financial statements. Each has an associated comment. The comments can be found starting on page 66.

#### **Auditors' Report [1]**

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##### **To the Directors of Troubled Society**

We have audited the Statement of Financial Position of Troubled Society as at March 31, 2006 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 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. Accordingly, our verification of this revenue was limited to the amounts recorded in the records of the Society and we were not able to determine whether any adjustments might be necessary to revenue, deficiency of revenue over expenses, assets and Net Assets. [3]

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 preceding paragraphs, these financial statements present fairly, in all material respects, the financial position of the Society as at March 31, 2006 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, 2006

**Troubled Society**  
**Statement of Financial Position**

**For the year ended March 31**

**2006**

**2005**

**Assets**

**Current**

Cash and short-term deposits (Note 1) [4]	\$	5,000	\$	20,000
Accounts receivable		20,000		10,000
Prepaid rent		2,000		2,000
		27,000		32,000

**Capital assets (Note 3)**

		950		-
		27,950		32,000

**Liabilities**

**Current**

Accounts payable and accrued liabilities [5]	\$	50,000	\$	7,000
Loan payable (Note 2) [6]		150,000		50,000
Deferred revenue		10,000		50,000
		210,000		107,000

**Net Assets**

Invested in capital assets		950		-
Available [7]		(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 [8]**

**For the year ended March 31, 2006**

	Invested in Capital Assets	Unrestricted	Total	
			2006	2005
<b>Balance</b> , beginning of year as previously stated	\$ -	\$ (8,217)	\$ <b>(75,000)</b>	\$ 20,000
Adjustment to prior period re: grant revenue (Note 6) [9]	-	-	-	(10,000)
<b>As restated</b>	-	(8,217)	<b>(75,000)</b>	10,000
Deficiency of revenue over expenses	(50)	(107,000)	<b>(107,050)</b>	(85,000)
Purchase of capital assets	1,000	(1,000)	-	-
<b>Balance</b> , end of year	\$ 950	\$ (116,217)	\$ <b>(182,050)</b>	\$ (75,000)

**Troubled Society**  
**Statement of Operations**

**For the year ended March 31**

**2006**

**2005**

**Revenue**

Donations and fundraising [10]	\$	215,000	\$	215,000
Fees and rentals		10,000		5,000
Training		3,000		100
Miscellaneous [11]		30,000		-
Government grants [12]		150,000		100,000
Interest		3,000		3,000
Administrative recoveries		3,000		3,000
		[13] 414,000		326,100

**Expenses**

Advertising and promotion [14]		5,000		1,000
Amortization expense		50		-
Bad debt expense [15]		25,000		5,000
Honourariums [16]		10,000		7,000
Insurance [17]		3,000		1,000
Interest charges [18]		10,000		5,000
Office expense and janitorial [19]		45,000		10,000
Rent [20]		100,000		75,000
Salaries and benefits		316,000		299,100
Telephone and utilities		7,000		6,000
		521,050		409,100

<b>Deficiency of revenue over expenses [21]</b>	<b>\$</b>	<b>(107,050)</b>	<b>\$</b>	<b>(83,000)</b>
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**Troubled Society**  
**Statement of Cash Flows [22]**

**For the year ended March 31**

**2006**

**2005**

**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	-

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	(107,000)	(85,000)
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Changes in non-cash working capital balances

Accounts receivable	(10,000)	(12,000)
Accounts payable and accrued liabilities	43,000	7,000
Deferred revenue	(40,000)	50,000

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	[23] (114,000)	(40,000)
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**Investing activities**

Acquisition of capital assets

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	(1,000)	-
--	---------	---

**Financing activity**

Increase in operating loan [24]

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	100,000	50,000
--	---------	--------

---

<b>Increase (decrease) in cash and short-term deposits for the year [25]</b>	(15,000)	10,000
--	----------	--------

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Cash and short-term deposits, beginning of year	20,000	10,000
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<b>Cash and short-term deposits, end of year [26]</b>	\$ 5,000	\$ 20,000
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**Troubled Society**  
**Summary of Significant Accounting Policies [27]**

**March 31, 2006**

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<b>General [28]</b>	The Troubled Society ("the Society") is incorporated under the Society Act of British Columbia and operates throughout the province.
<b>Capital Assets</b>	Capital assets are recorded at cost and amortization is provided as follows:  Equipment                      - 10% straight line
<b>Revenue Recognition</b>	<p>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.</p> <p>Revenues and expenses relating to donor campaigns are deferred until completion of the campaign. Lottery proceeds are accounted for on a completed lottery basis.</p> <p>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.</p>
<b>Contributed Services</b>	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.
<b>Expense Recoveries</b>	Expense recoveries revenue includes administration costs charged to other organizations as well as charges to special projects carried out within the Society.
<b>Financial Instruments</b>	The Society's financial instruments consist of cash and short-term deposits, accounts receivable, accounts payable and accrued liabilities and loan payable. Unless otherwise noted, it is management's opinion that the Society is not exposed to significant interest, currency or credit risks arising from these financial instruments.
<b>Use of Estimates</b>	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.

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**Troubled Society**  
**Notes to Financial Statements [29]**

**March 31, 2006**

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**1. Cash and Short-term 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 (2005 - \$20,000) earns interest at 4.45% (2003 - 4.15%) and matures on October 31, 2007.

---

**2. Loan Payable and Subsequent Event**

The Society has an operating loan due on November 9, 2007 [30] which bears interest at 10.25%, [31] calculated semi-annually and repaid by monthly principal payments of \$1,500 plus interest. The loan is collateralized by the \$20,000 term deposit [32] (Note 1).

---

**3. Capital Assets**

	2006		2005	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Office equipment	\$ 1,000	\$ 50	\$ 950	\$ -

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**4. Commitments [33]**

The Society has leases for its premises at \$8,333 per month and for equipment at \$2,500 per month [34] both of which expire on March 31, 2009. [35]

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**5. Contingent Liabilities [36]**

A number of legal claims have been initiated against the Society [37] in varying and unspecified amounts. The outcome of these claims cannot reasonably be determined at this time. [38]

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**6. 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. [39]

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## Comments on Troubled Society Financial Statements

### Comment [1]:

It is important to actually read the auditors' report. Often there is a focus on the numbers only. In many cases the financial statements 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 places 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]:

Cash levels have decreased significantly. Could be an indication of deteriorating financial position.

### [5]:

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

A director of this organization would also want to ask if the GST and employee tax remittances were up to date as there is potential for personal liability if those not paid.

### [6]:

Loan balance has increased substantially. Looks like they needed to borrow 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?

### [7]:

Serious deficit position AND the deficit position has got much worse in the last year going from \$75,000 to \$183,000

### [8]:

In general this statement will usually not be of great value to non-accountants.

**[9]:**

When an error is found in a prior year financial statement the error is retroactively adjusted and disclosed as an “adjustment to prior period”. These do occur in most organizations from time to time, but 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 in several years.

**[10]:**

This is at least partially positive in that donors are not abandoning the organization since the level of revenue the same as prior year. Of course, the organization may need more revenues to survive.

**[11]:**

This is also positive, however would question the source of the revenue and particularly if it was an one-time or recurring item. This organization needs a source of future revenues.

**[12]:**

A 50% increase in government grants is also positive. However, since expenses increased more than revenues, would question whether the cost of delivering on the services supported by the government grant is out of line.

**[13]:**

A great increase in revenues, yet poor overall results. Why?

**[14]:**

Significant increase in this expense, but it may be necessary to increase profile to help fundraise. Would question though.

**[15]:**

Bad debt expense represents items that were reported as revenue because they were committed to be received, yet never actually received. Unusual for an organization with revenues from funders and government to have any bad debts. Would question: why any bad debts at all? Is organization grants or donations before the funder has committed to paying them? Why such a large increase from prior year?

**[16]:**

Would question – would expect an organization in financial difficulty to be cutting back on such discretionary items.

**[17]:**

Insurance costs have tripled. Are there claims or risk problems?

**[18]:**

Interest charges have doubled because of the loan increase.

**[19]:**

This seems to be an incredibly high level of increase in this expense. This is an organization in financial crisis and should be cutting costs where possible.

**[20]:**

A 33% increase in rent. Why? Would expect the organization to be cutting costs where possible.

**[21]:**

One of the most important indicators is the net results for the year. This organization lost a lot of money last year (\$83,000) and even more this year (\$107,050). Obviously it cannot continue indefinitely with such losses. Would have to question management about plans for turning things around.

**[22]:**

This is a statement that will be of limited use to most readers who are not accountants.

**[23]:**

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.

**[24]:**

This shows that loan balance has increased \$50,000 last year and a further \$100,000 this year. It has allowed the organization to survive, but how will it be paid back?

**[25]:**

An overall decrease in cash this year of \$15,000. Cash balances will fluctuate but would ask about why decrease for year and how will turn the cash flow around to positive.

**[26]:**

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

**[27]:**

Accounting policies have to be disclosed when there is a choice amongst two or more acceptable accounting principles or to provide some additional technical accounting information. Usually, there will not be much useful reading here for non-accountants.

**[28]:**

It is common that the first note here (or the first note of the formal Notes to the Financial Statements) will speak to the purpose of the organization, its tax status, and other useful information so it should be read.

Also, when an organization is in financial difficulty there will usually be a description of management plans to rectify the situation. This is missing here but likely should have been provided.

**[29]:**

Notes to the Financial Statements are often glossed over by readers and many times are not even included when an organization sends out its information in newsletters or on websites. Anyone wanting to understand the financial position of the organization needs to review the Notes also.

**[30]:**

The loan is due in just a few months! How can the organization afford to repay it? What will happen if they don't?

**[31]:**

Expensive financing at 10.25%.

**[32]:**

The loan is 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 \$15,000 overdrawn. This is not good.

**[33]:**

Always a good note to read because an organization must show every contract that it is committed to and the financial cost of that commitment for at least the next 5 years.

**[34]:**

Both the premises and the equipment seem very expensive. Especially for an organization that should be cutting back on expenses and trying to turn its finances around.

**[35]:**

These leases run for a long time (three years from the date of this statement). This is a very large financial obligation that the organization will have to overcome. Might question whether buyout or sublease was possible.

**[36]:**

Always a good note to read because will discuss items that could turn into a liability for the organization.

**[37]:**

A number of claims! Could be some real problems. Would question the nature of the claims, potential liability, action taken, etc.

**[38]:**

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.

**[39]:**

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. Would question management to ensure that policy on recording of grant revenues has been changed.

## ***Sample Financial Statement***

The following pages represent one way in which financial statements can be expected from an auditor, with sample language, categories of expenses, and so on. This sample has been provided simply to you the quality of reporting you should expect from your auditor.

### **Sample Statement 2 Financial Statements For the year ended March 31, 2006**

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#### **Contents**

#### **Auditors' Report**

#### **Financial Statements**

Statement of Financial Position

Statement of Operations

Statement of Changes in Net Assets

Statement of Cash Flows

Summary of Significant Accounting Policies

Notes to Financial Statements

Schedule 1 - Revenue and Direct Expenses

Schedule 2 - Other Revenue and Other Direct Expenses

Schedule 3 - Administrative Expenses

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## Auditors' Report

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### To the Members of Sample Statement 2

We have audited the Statement of Financial Position of Sample Statement 2 as at March 31, 2006 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 Association'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.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Association as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles. As required by the Society Act (British Columbia), we report that, in our opinion, these principles have been applied on a basis consistent with that of the preceding year.

Chartered Accountants

Vancouver, British Columbia  
June 7, 2006

**Sample Statement 2**  
**Statement of Financial Position**

March 31	2006	2005
<b>Assets</b>		
<b>Current</b>		
Cash (Note 1)	\$ 258,208	\$ 343,438
Term Deposit (Note 1)	500,000	500,000
Accounts receivable (Note 2)	45,859	45,965
Inventory	12,843	12,843
Prepaid expenses	17,346	17,346
	834,256	919,592
<b>Property and equipment (Note 3)</b>	<b>444,855</b>	<b>458,958</b>
	<b>\$ 1,279,111</b>	<b>\$ 1,378,550</b>

**Liabilities and Net Assets**

**Liabilities**

<b>Current</b>		
Accounts payable and accrued liabilities	\$ 263,130	\$ 407,203
Deferred revenue	281,290	316,555
Current portion of capital lease obligation (Note 4)	3,128	5,611
Current portion of mortgage payable (Note 5)	-	72,237
	547,548	801,606
<b>Obligation under capital lease (Note 4)</b>	-	3,130
<b>Unspent capital funding</b>	<b>19,992</b>	-
<b>Deferred capital contributions (Note 6)</b>	<b>94,804</b>	<b>82,074</b>
	<b>662,344</b>	<b>886,810</b>
<b>Net Assets</b>		
Net assets invested in property and equipment	346,923	295,906
Net assets internally restricted for contingency purposes	200,000	200,000
Net assets available	69,844	(4,166)
	616,767	491,740
	<b>\$ 1,279,111</b>	<b>\$ 1,378,550</b>

Approved on behalf of the Board:

\_\_\_\_\_ Director \_\_\_\_\_ Director

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**Sample Statement 2**  
**Statement of Operations**

<b>For the year ended March 31</b>	<b>2006</b>	<b>2005</b>
<b>Revenue</b> (Schedule 1)	<b>\$ 3,848,752</b>	<b>\$ 3,587,366</b>
<b>Direct expenses</b> (Schedule 1)	<b>3,157,337</b>	<b>3,023,334</b>
<b>Net revenue before administrative expenses</b>	<b>691,415</b>	<b>564,032</b>
<b>Administrative expenses</b> (Schedule 3)	<b>566,388</b>	<b>518,951</b>
<b>Net revenue over expenses for the year</b>	<b>\$ 125,027</b>	<b>\$ 45,081</b>

**Sample Statement 2**  
**Statement of Changes in Net Assets**

**For the year ended March 31**

	Invested In Property and Equipment	Internally Restricted	Available	<b>2006</b>	2005
<b>Balance, beginning of year</b>	\$ 295,906	\$ 200,000	\$ (4,166)	<b>\$ 491,740</b>	\$ 446,659
Revenue over expenses for year	(30,507)	-	155,534	<b>125,027</b>	45,081
Interfund transfers	81,524	-	(81,524)	-	-
<b>Balance, end of year</b>	<b>\$ 346,923</b>	<b>\$ 200,000</b>	<b>\$ 69,844</b>	<b>\$ 616,767</b>	<b>\$ 491,740</b>

**Sample Statement 2**  
**Statement of Cash Flows**

**For the year ended March 31**

**2006**

**2005**

**Cash provided by (used in)**

**Operating activities**

Net revenue over expenses for the year	\$ 125,027	\$ 45,081
Items not requiring (generating) cash		
Non-cash donation	(3,000)	(8,519)
Amortization of deferred capital contributions	(40,400)	(29,162)
Amortization of property and equipment	73,907	62,725
Loss on theft	-	1,905
Loss on sale of equipment	-	1,050
Changes in non-cash working capital balances	<u>(179,232)</u>	<u>224,693</u>
	<u>(23,698)</u>	<u>297,773</u>

**Investing activities**

Purchase of property and equipment	(56,803)	(108,058)
Purchase of term deposit	-	(500,000)
Proceeds on sale of property and equipment	-	1,386
	<u>(56,803)</u>	<u>(606,672)</u>

**Financing activities**

Principal payment on mortgage	(72,237)	(30,796)
Principal payments on capital leases	(5,613)	(6,182)
Government grant for purchase of property and equipment	73,121	62,353
	<u>(4,729)</u>	<u>25,375</u>

**Decrease in cash during the year**

(85,230) (283,524)

**Cash, beginning of year**

343,438 626,962

**Cash, end of year**

\$ 258,208 \$ 343,438

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## Sample Statement 2 Summary of Significant Accounting Policies

**March 31, 2006**

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### **Purposes of the Association**

The Association is incorporated under the Society Act of British Columbia. The purposes of the Association are to serve the residents of the lower mainland.

In the event of winding up or dissolution, the Association's constitution states that the assets will be available for distribution to an organization situated in British Columbia devoted to the relief of poverty in Canada or some other purpose beneficial to a Canadian community.

### **Net Assets**

The Association segregates its net assets based on any restrictions related to such balances.

Net assets invested in property and equipment represents the Association's investment in property and equipment.

Internally restricted net assets represents those funds restricted by Board designation for property and equipment. The amounts are not available for purposes other than those designated without approval from the Board of Directors.

### **Inventory**

Inventory is stated at the lower of cost and replacement cost which is not in excess of net realizable value. Cost is generally determined on a first-in, first-out basis.

### **Property and Equipment**

Property and equipment are recorded at cost less accumulated amortization. Amortization is provided as follows:

Computer equipment	- 3 years straight line basis
Other equipment and furniture	- 10 years straight line basis
Building	- 20 years straight line basis

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## Sample Statement 2

### Summary of Significant Accounting Policies

**March 31, 2006**

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**Assets Under  
Capital Lease**

Leases that transfer the risks and benefits of ownership to the Association are capitalized based on the present value of future lease payments. The leased assets are recorded at cost less accumulated amortization. The assets are amortized over the term of the lease.

**Income Taxes**

The Association is exempt from income tax under Section 149(1)(f) of the Income Tax Act.

**Donated Goods  
and Services**

The Association records donated goods and services at their fair market value where that value can be reasonably estimated and the goods or services would normally be purchased by the Association. Donated supplies and equipment have been recorded in the amount of \$3,000 (2005 - \$8,519) and donated services for \$NIL (2005 - \$1,122).

**Revenue Recognition**

The Association follows the deferral method of accounting for contributions.

Restricted contributions are recognized as revenue in the year in which the related expenses are incurred. Restricted contributions for the acquisition of property and equipment are deferred and amortized over the remaining useful life of the asset acquired.

Unrestricted contributions are recognized as revenue when received or receivable if the amount can be reasonably estimated and collection is reasonably assured.

**Financial Instruments**

The Association's financial instruments consist of cash, term deposit, accounts receivable, accounts payable and accrued liabilities, obligation under capital lease and mortgage payable. Unless otherwise noted, management does not believe that these financial instruments are subject to any significant currency, credit or interest rate risks. The carrying value of these financial instruments approximates their fair value.

**Use of Estimates**

The preparation of financial statements in accordance with Canadian 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 differ from management's best estimates as additional information becomes available in the future.

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**Sample Statement 2**  
**Notes to Financial Statements**

**March 31, 2006**

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**1. Cash, Term Deposits and Credit Facility**

The Association has a credit facility agreement with its bank which allows it to borrow up to a maximum of \$125,000 at an interest rate of prime plus 1%. The credit facility agreement is collateralized by a second charge on land and building, assignment of rents, fire insurance and a general assignment of book assets. At March 31, 2006 the Association had not utilized any of the amount available.

As at March 31, 2006, the Association had two bank accounts at one credit union which earn interest at the prevailing rates for savings accounts.

The term deposit matures July 7, 2006 and earns interest at 1.4%.

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**2. Accounts Receivable**

	<u>2006</u>	<u>2005</u>
Staff	\$ -	\$ 1,581
Trade	<b>39,657</b>	33,730
Other	<b>6,202</b>	10,654
	<u><b>\$ 45,859</b></u>	<u>\$ 45,965</u>

Trade receivables are stated net of an allowance for doubtful accounts in the amount of \$4,000 (2005 - \$4,000).

**Sample Statement 2**  
**Notes to Financial Statements**

**March 31, 2006**

**3. Property and Equipment**

	<b>2006</b>		<b>2005</b>	
	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>	<b>Net Book Value</b>
Equipment	\$ 150,053	\$ 128,068	\$ 21,985	\$ 23,197
Equipment	15,570	2,907	12,663	3,512
Computer equipment	279,337	256,250	23,087	33,087
Office equipment	150,268	119,263	31,005	27,817
Office furniture	76,106	40,721	35,385	29,650
Leased equipment	19,785	17,954	1,831	6,077
Building	542,226	468,446	73,780	90,499
Land	245,119	-	245,119	245,119
	<b>\$ 1,478,464</b>	<b>\$ 1,033,609</b>	<b>\$ 444,855</b>	<b>\$ 458,958</b>

**4. Obligation Under Capital Lease**

The Association leases certain equipment by capital lease. The following amounts are outstanding:

	<b>2006</b>		<b>2005</b>	
Lease for computer equipment at effective interest rate of 23% per annum, repayable \$426 principal and interest monthly to November 2006	\$	<b>3,128</b>	\$	6,999
Lease for computer equipment at effective interest rate of 13% per annum, repayable \$185 principal and interest monthly to September 2005		-		1,411
Lease for computer equipment at effective interest rate of 14% per annum repayable \$113 principal and interest monthly to July 2005		-		331
		<b>3,128</b>		8,741
Less current portion		<b>3,128</b>		5,611
	<b>\$</b>	<b>-</b>	<b>\$</b>	<b>3,130</b>

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**Sample Statement 2**  
**Notes to Financial Statements**

**March 31, 2006**

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**4. Obligation Under Capital Lease - Continued**

The future minimum lease payments until maturity are as follows:

2007	\$	3,411
Less imputed interest		<u>283</u>
	<u>\$</u>	<u>3,128</u>

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**5. Mortgage Payable**

The mortgage was collateralized by a first charge on land and building and was repaid in May 2005.

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**6. Deferred Capital Contributions**

	<u>2006</u>	<u>2005</u>
Unamortized balance, beginning of year	\$ 82,074	\$ 48,883
Contributions for property and equipment received in year	73,122	62,353
Unspent	(19,992)	-
Amortized to revenue	<u>(40,400)</u>	<u>(29,162)</u>
Unamortized balance, end of year	\$ 94,804	\$ 82,074

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**7. Economic Dependence**

The Association receives approximately 60% (2005 - 62%) of its total revenues from the Province of British Columbia.

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**Sample Statement 2**  
**Notes to Financial Statements**

**March 31, 2006**

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**8. Commitments**

The Association has an operating lease for a photocopier.

The future minimum lease payments until maturity are as follows:

Year	Amount
2007	\$ 8,423
2008	8,423
2009	8,423
2010	8,423
2011	<u>8,423</u>
	<u>\$ 42,115</u>

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**9. Employee Future Benefits**

The Association provides an annual bonus to qualified employees. An employee qualifies after completing their second year of employment. The amount of the bonus is set based on years of service, prorated for part-time employees. The bonus payment is made on the anniversary date of the employees. The Association paid \$69,398 (2005 - \$68,205) to the employees this past year.

An employee is entitled to three to eight weeks of annual paid vacation leave. These paid vacation days are accrued monthly as soon as commencement of employment and are available for use in the following fiscal year. The Association has accrued \$73,198 (2005 - \$100,907) for unused vacation and these amounts are included in accounts payable and accrued liabilities.

**Sample Statement 2**  
**Schedule 1 - Revenue and Direct Expenses**

**For the year ended March 31, 2006**

	2006				
	ServiceA	ServiceB	ServiceC	Other (Schedule 2)	Total
<b>Revenue</b>	<b>\$ 1,996,479</b>	<b>\$ 899,169</b>	<b>\$ 276,647</b>	<b>\$ 676,457</b>	<b>\$ 3,848,752</b>
<b>Direct expenses</b>					
Bad debts	-	721	-	-	721
Insurance	18,119	-	-	-	18,119
Equipment repair	803	1,852	-	-	2,655
Salaries and wages	1,517,942	691,172	83,026	328,657	2,620,797
Supplies and expenses	20,788	141,944	177,924	170,540	511,196
Travel	3,849	-	-	-	3,849
	<b>1,561,501</b>	<b>835,689</b>	<b>260,950</b>	<b>499,197</b>	<b>3,157,337</b>
<b>Net revenue</b>	<b>\$ 434,978</b>	<b>\$ 63,480</b>	<b>\$ 15,697</b>	<b>\$ 177,260</b>	<b>\$ 691,415</b>

	2005				
	ServiceA	ServiceB	ServiceC	Other (Schedule 2)	Total
<b>Revenue</b>	<b>\$ 2,029,600</b>	<b>\$ 761,744</b>	<b>\$ 263,551</b>	<b>\$ 532,471</b>	<b>\$ 3,587,366</b>
<b>Direct expenses</b>					
Bad debts	25	1,605	-	-	1,630
Insurance	24,421	-	-	-	24,421
Equipment repair	391	9,488	-	-	9,879
Other expenses	-	11,716	-	-	11,716
Salaries and wages	1,519,173	664,254	84,603	215,761	2,483,791
Supplies and expenses	21,456	127,720	177,047	161,920	488,143
Travel	3,754	-	-	-	3,754
	<b>1,569,220</b>	<b>814,783</b>	<b>261,650</b>	<b>377,681</b>	<b>3,023,334</b>
<b>Net revenue (expenses)</b>	<b>\$ 460,380</b>	<b>\$ (53,039)</b>	<b>\$ 1,901</b>	<b>\$ 154,790</b>	<b>\$ 564,032</b>

**Sample Statement 2**  
**Schedule 2 - Other Revenue and Other Direct Expenses**

<b>For the year ended March 31</b>	<b>2006</b>	<b>2005</b>
<b>Other revenue</b>		
Bingo	\$ 167,290	\$ 166,048
Members	569	219
Centre	7,963	9,313
Donations	7,281	11,568
Amortization of deferred capital contributions	40,400	29,162
Primary Program	108,440	34,560
Miscellaneous	33,380	12,808
Rental	32,574	31,109
Family Services	278,560	236,937
Nutrition program grants	-	747
	<u>676,457</u>	<u>532,471</u>
<b>Other direct expenses</b>		
Fundraising	39,767	28,321
Subscription and pamphlets	356	910
Family Services	286,456	274,866
Nutrition programs	197	402
Primary Program	129,957	34,560
Primary Program - Amortization	40,400	29,162
Other	2,064	9,460
	<u>499,197</u>	<u>377,681</u>
	<u>\$ 177,260</u>	<u>\$ 154,790</u>

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**Sample Statement 2**  
**Schedule 3 - Administrative Expenses**

<b>For the year ended March 31</b>	<b>2006</b>	<b>2005</b>
<b>Administrative expenses</b>		
Advertising and promotion	\$ 6,852	\$ 2,120
Amortization of property and equipment	33,507	33,563
Audit, accounting and legal	36,055	23,298
Bank charges and interest	4,943	2,273
Equipment rental and maintenance	23,622	22,728
Insurance	16,484	14,190
Interest on long-term debt	591	4,452
Janitorial and garbage	30,103	30,696
Light, heat and power	19,856	19,238
Loss on theft and sale	-	2,955
Miscellaneous	20,115	10,297
Office supplies	17,702	23,665
Payroll fees	10,589	2,987
Printing and stationery	12,833	12,144
Professional and consulting	20,635	21,112
Property taxes	2,578	2,441
Repairs and maintenance	44,895	36,835
Salaries and wages	232,990	220,441
Staff education	11,179	7,846
Telephone	20,859	25,670
	\$ 566,388	\$ 518,951

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## Glossary of Terms

<b>Accountability</b>	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.
<b>Accounts payable</b>	Amounts owed by an organization, eg. unpaid bills for purchases, monthly obligations, loan repayments.
<b>Accounts Receivable</b>	Amounts owed to an organization services or programs that the organization has delivered prior to receiving the income or provided for on credit.
<b>Amortization</b>	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.
<b>Annual General Meeting (AGM)</b>	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.
<b>Annual report</b>	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.
<b>Arm's Length Transaction</b>	A transaction that is conducted as though the parties were unrelated, thus avoiding any conflict of interest.
<b>Articles of incorporation</b>	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.
<b>Assets</b>	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.
<b>Audit</b>	Independent verification of economic events.
<b>Auditor</b>	A firm of Chartered Accountants hired to give an independent opinion on the organization's financial statements.
<b>Auditor's Report</b>	In an annual report, the auditor's opinion on the organization's financial data and supporting evidence.
<b>Balance sheet</b>	An accounting statement of an organization's financial condition as of a certain date, generally at the end of its fiscal quarter or year.
<b>Basis Price</b>	1/100th of 1% in yield; hence 50 basis points is 1/2 of 1%.
<b>Bearish</b>	An attitude or indication implying that prices are likely to experience a substantial decline.
<b>Board of Directors</b>	A group of volunteers chosen to govern the affairs of a non-profit organization.
<b>Bonds</b>	Marketable and non-marketable securities issued in Canadian or foreign currency with an original term to maturity in excess of one year
<b>Budget</b>	A financial report containing estimates of income and expenses.
<b>Bullish</b>	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.

<b>By laws</b>	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.
<b>CA</b>	Chartered Accountant
<b>Capacity Building</b>	The process of building the potential for not-for-profit organizations to respond to the needs of the community they serve.
<b>Capital Gain</b>	The profit you get when you sell an asset, like an investment, for more than you paid for it.
<b>Capital Loss</b>	When the sale price of an asset is lower than its purchase price, you have a capital loss.
<b>Capital reserve</b>	Monies set aside for capital purposes.
<b>Cash flow</b>	The flow of monies into (receipts) and out of (disbursements) the organization.
<b>Cash flow forecast</b>	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.
<b>CGA</b>	Certified General Accountant
<b>Charity</b>	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.
<b>CMA</b>	Certified Management Accountant
<b>Collaborative</b>	A formal or semi-permanent partnership created between two or more organizations in order to better achieve mutually desired objectives.
<b>Collateral</b>	Property (real, personal or otherwise) pledged as security for a loan. Also, any supplementary promise of payment, such as a guarantee.
<b>Collateral Mortgage</b>	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.
<b>Constitution</b>	A system, often a written document, which establishes the rules and principles by which an organization is governed.
<b>Contingency planning</b>	Allowing for financial flexibility in preparing a budget in order to meet unanticipated events.
<b>Corporate giving program</b>	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.
<b>Corporate Sponsorship</b>	Group sponsorship, normally from the business community. Corporate sponsorship is often done in exchange for publicity.
<b>Cost</b>	The amount paid or charged for something.

<b>Credit Rating</b>	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
<b>Credit Risk</b>	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.
<b>Debt</b>	Money owed.
<b>Default</b>	A borrower defaults on his obligations when he fails to make a required payment of principal or interest at a specified time.
<b>Deferred Revenue</b>	Income for which the cash has been collected by the organization, but has yet to be "earned".
<b>Deficit</b>	A deficiency in amount - an excess of expenditures over revenue.
<b>Deliverables</b>	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%.
<b>Demand Loan</b>	A loan that must be repaid in full, on demand.
<b>Depreciation</b>	The amount of expense charged against earnings by an organization to write off the cost of a plant or machine over its useful live, giving consideration to wear and tear, obsolescence, and salvage value.
<b>Direct deposit</b>	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.
<b>Disbursement</b>	Payment.
<b>Disbursement quota</b>	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.
<b>Discretionary funds</b>	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.
<b>Donor</b>	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.
<b>Due Diligence</b>	Process of investigating all risks associated with an organization or grantee.
<b>Economic Development</b>	Any effort or undertaking which aids in the growth of the economy.
<b>EFT/POS</b>	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.
<b>Electronic Funds Transfer (EFT)</b>	A system that transfers funds through electronic messages instead of by traditional means, such as cash or cheques.
<b>Executive Director</b>	A person employed by a non-profit organization to oversee operations and management and implement the policy decisions of the Board of Directors.
<b>Expenditure</b>	Actual expenses incurred at the end of a reporting period or a fiscal year.

<b>Expense</b>	A cost, eg. stationery and supplies, printing and duplicating, postage and telephone.
<b>Fiduciary duty</b>	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.
<b>Financial Disclosure</b>	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.
<b>Financial report</b>	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.
<b>Fiscal year</b>	The accounting year of an organization, which may or may not be the same as the calendar year.
<b>Fixed assets</b>	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.
<b>Fixed expenses</b>	Fixed operational costs that do not change with the volume of activities, such as rent for business premises, insurance payments, utilities, etc.
<b>Form T3010A</b>	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.
<b>Foundation</b>	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.
<b>Four Pillars</b>	A term used to describe the main types of financial institutions: banking, trust, insurance and securities
<b>Fund</b>	A sum of money or resources intended for a special purpose.
<b>Funding cycle</b>	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.
<b>GAAP</b>	Generally Accepted Accounting Principles: A set of rules and guidelines for reporting financial information. Each country may have its own GAAP.
<b>GIC</b>	Guaranteed Investment Certificate: An investment in which you deposit money, over a fixed period of time, and are paid a set rate of interest.
<b>Gifts in-kind</b>	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.
<b>Governance</b>	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.
<b>Grant</b>	A sum of money given by a donor to support the work of a Not-for-Profit Organization.
<b>Infrastructure</b>	Base or foundation of a world system (ie. economy, society, organization). It is the basic equipment required for a particular system to function.
<b>Insurance</b>	Coverage by contract whereby one party agrees to indemnify or guarantee another against loss by a specified contingent event or peril.

<b>Internal control</b>	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.
<b>Investment</b>	Using money to provide income or profit.
<b>Investment Income</b>	This is income earned on investments you make. Investment income includes interest, dividends and capital gains.
<b>Invoice</b>	Bill for goods or services received or provided.
<b>Journal</b>	A record of transactions, can be manual or computerized.
<b>Lease</b>	An agreement to rent for a period of time at an agreed price.
<b>Letter of Credit</b>	A written undertaking from a bank guaranteeing payment.
<b>Leverage</b>	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.
<b>Line of Credit</b>	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.
<b>Liquidity</b>	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.
<b>Long-term liabilities</b>	Money that you owe over a period longer than 12 months, such as mortgages, bank loans and other obligations.
<b>Minimum monthly balance</b>	The least amount of money that has been in a bank account during the whole month.
<b>Mission Statement</b>	A brief statement outlining the specific task(s) for which a group has charged itself.
<b>Money Markets</b>	The part of the capital market where government Treasury bills, commercial paper, bankers' acceptances and other short-term obligations are bought and sold
<b>Mutual Fund</b>	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
<b>Notes and Disclosures</b>	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.
<b>N.S.F. Cheque</b>	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
<b>Operating Loan</b>	A loan intended for short-term financing, supplying cash flow support or to cover day-to-day operating expenses.
<b>Operating Expenses</b>	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.

<b>Overdraft</b>	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.
<b>Policy</b>	A course or principle of action adopted by a government, party, business or individual.
<b>Prime Lending Rate</b>	The rate of interest charged on loans by credit unions, banks, trust companies to their most creditworthy customers.
<b>Promissory Note</b>	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.
<b>Ratio</b>	Comparison of two figures used to evaluate business performance, such as debt/equity ratio and return on investment.
<b>Reconciliation</b>	Checking all bank account papers to make sure that the bank's records and your records agree.
<b>Request for Proposal (RFP)</b>	An RFP is similar to a job posting, but for a contractor for a specific project. It lists project specifications and application procedures.
<b>Return</b>	Any increase in value or in income you earn on an investment.
<b>Risk Tolerance</b>	Your comfort level with accepting possible losses from your investments.
<b>Rule of 72</b>	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.
<b>Securities</b>	Investments such as stocks and bonds.
<b>Sponsor</b>	A person or organization, usually a business, that supports an activity by pledging money in advance.
<b>Statement</b>	A computer printout which lists all the transactions in a bank account for a period of time. Statements are usually given once a month.
<b>Stocks</b>	Traded on a stock exchange, these are shares in a company. Essentially, you purchase shares in exchange for owning a part of that company.
<b>Strategic Plan</b>	A future-oriented perspective where organization's decisions are made based on an analysis of external and internal trends and data.
<b>Sustainability</b>	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.
<b>Term deposit</b>	An investment in which you deposit money, over a fixed period of time, and are paid a set rate of interest.
<b>Term Loan</b>	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.
<b>Treasury Bills (T-Bills)</b>	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.
<b>Variable expenses</b>	Costs of doing business that vary with the volume of business, such as advertising costs, manufacturing costs and bad debts.
<b>Venture Capital</b>	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.

## **Web Resources**

### **Financial Management**

#### **[Basic Guide to Non-Profit Financial Management](#)**

The Basic Guide to Non-Profit Financial Management is written by Carter McNamara and is available, free of charge, from [The Free Management Library](#). Topics include the basics of financial management, bookkeeping and controls, critical operating activities in the yearly accounting cycle, managing program finances, and financial statements and analysis.

#### **[Cass & Fraser Chartered Accountants](#)**

Offered by Cass & Fraser Chartered Accountants of Alberta, this site includes information on accounting principles and techniques for not-for-profit organizations.

- Click on "Accounting Tutorial" for an explanation of some common not-for-profit journal entries, and the process of posting entries and compiling financial statements.

#### **[Ethical Fundraising and Financial Accountability Code](#)**

The ethical fundraising and financial accountability code from [Imagine Canada](#) is a set of standards and benchmarks that enables organizations to manage their funds responsibly and report their financial affairs accurately and completely. Any Canadian charity can adopt the code and become registered as an adherent to the code. Registered adherents are listed on Imagine Canada's website and promoted as responsible charities. Adherents also get special recognition as ethical fundraisers on CanadaHelps.org, an online donation portal that allows people to donate to their favourite charity. For more information about the ethical code or to request a licensing package, contact the Ethical Code Program at ext. 221, 1-800-263-1178, or by [e-mail](#).

#### **[Nonprofit Financial Centre](#)**

The Nonprofit Financial Centre is a nonprofit organization dedicated to helping nonprofits grow and prosper through practical financial management. Although based in the USA, much of the information is still applicable to Canadian organizations, however some of the services are available to members only.

- Click on "Information Resources" for a variety of on-line guides to financial management such as a sample Financial Policies & Procedures handbook.

#### **[Voluntary Sector Knowledge Network](#)**

Click on "Financial Management" for a good overview of accounting and budgeting. In the "Accounting for Nonprofits" section, there is a good article on preparing your cash flow statement - including why you need one.

## ***Print Publications***

### **All the Way to the Bank: Smart Nonprofit Money Management, 2nd ed.**

Author: Allen, Larson

Publisher: Larson Allen Weishair & Co, 2002

ISBN: 0965220893

Solid financial support and management are key to mission success. Make the most of the resources you have with the tools and techniques in this book.

### **Bookkeeping Basics: What Every Nonprofit Bookkeeper Needs to Know**

Author: Ruegg, Debra L. and Lisa M. Venkatrathnam

Publisher: Amherst Wilder, 2003

ISBN: 0940069296

Gives you enough knowledge and skills to track the financial activity of your nonprofit. Includes step-by-step instructions, detailed examples and forms to use.

### **Bookkeeping for Nonprofits: A Step-by-Step Guide to Nonprofit Accounting**

Author: Dropkin, Murray

Publisher: Wiley, 2005

ISBN: 0787975400

Contains the tools needed to create and maintain a complete and accurate set of accounting records. Those with little or no bookkeeping experience will appreciate the many illustrations and checklists.

### **Budget-Building Book for Nonprofits, The: A Step-by-Step Guide for Managers and Boards**

Author: Dropkin, Murray and LaTouche, Bill

Publisher: Jossey-Bass, 1998

ISBN: 0787940364

Guides nonprofit executives and Boards through the budget cycle, offering practical instruction on completing each step of the process. Includes examples, to-do lists, worksheets, schedules, and other hands-on tools.

### **Cash Flow Management Book for Nonprofits, The: a Step-by-Step Guide for Managers, Consultants, and Boards**

Author: Dropkin, Murray and Allyson Hayden

Publisher: Jossey-Bass, 2001

ISBN: 0787953857

Presents a plan for cash flow management and effective strategies for day-to-day and long-term financial planning. A practical workbook with worksheets, sample forms, and more.

### **Effective Economic Decision-Making by Nonprofit Organizations**

Author: Young, Dennis, ed.

Publisher: Foundation Center and National Center on Nonprofit Enterprise, 2004

ISBN: 1931923698

Twelve experts share their insights on core operating decisions, resource development issues, and strategic decisions on programmatic ventures.

### **Financial Leadership for Nonprofit Executives**

Author: Peters, Jeanne and Elizabeth Schaffer

Publisher: Amherst H. Wilder Foundation, 2005

ISBN: 0094006944

Gives the framework, specific language, and processes to manage a successful nonprofit. It shows how to protect and grow the assets of an organization and accomplish as much mission as possible with those resources.

### **Financial Leadership for Nonprofit Executives: Guiding Your Organization to Long-term Success**

Author: Peters, Jeanne

Publisher: Amherst H. Wilder Foundation, 2005

ISBN: 094006944X

Gives the framework, specific language, and processes to manage a successful nonprofit. It shows how to protect and grow the assets of an organization and accomplish as much mission as possible with those resources.

### **Financial Responsibilities of Nonprofit Boards, rev. ed.**

Author: Lang, Andrew S.

Publisher: BoardSource, 2003

ISBN: 1586860550

Provide your Board members with an understanding of their financial responsibilities including an overview of financial oversight and ways to ensure against risk.

### **Fiscal Sponsorship: 6 Ways to do it Right**

Author: Colvin, Gregory

Publisher: Study Center Press, 2000

ISBN: 093643466X

In cases when forming a new nonprofit organization is not feasible, a fiscal sponsorship arrangement may be worthwhile. Six models are provided to show how a project can benefit from a relationship with a sponsor.

### **Generating and Sustaining Nonprofit Earned Income: A Guide to Successful Enterprise Strategies**

Author: Oster, Sharon M.

Publisher: Jossey-Bass, 2004

ISBN: 078797238X

Help your organization achieve greater financial stability through a diversified stream of revenue. This resource teaches how to establish and manage an earned income venture to free your organization from excessive dependence on fundraising.

### **Grant Seeker's Budget Toolkit**

Author: Quick, James Aaron and Cheryl Carter New.

Publisher: John Wiley, 2001

ISBN: 0471391409

This book walks readers through the entire budgeting process, providing insider tips, guidelines, and general rules. More importantly, it arms readers with a complete, step-by-step budgeting system.

**Guide to Nonprofit Contributions, 4th ed.**

Author: Practitioners Publishing Corporation  
Publisher: Practitioners Publishing Corporation, 2001  
ISBN: 0764604899

Provides numerous examples of different types of contributions and thoroughly discusses the proper accounting treatment for each. Addresses operating considerations relating to contributions, including fraud, internal controls and tax considerations.

**Guide to Nonprofit Expenses, 4th ed.**

Author: Practitioners Publishing Corporation  
Publisher: Practitioners Publishing Corporation, 2001  
ISBN: 076461021X

Provides numerous example expense allocation methods and financial statement presentations and discusses operating concerns relating to nonprofit expenses, including internal controls, fraud examples, and perceptions of charity watchdog groups.

**Model Policies and Procedures for Not-For-Profit Organizations**

Author: McMillan, Edward J.  
Publisher: Wiley, 2003  
ISBN: 0047145317

Model policies for accounting and finance, internal controls, risk reduction and office administration. An associated Web site contains all of the documents found in the book.

**Nonprofit Financial and Accounting Manual**

Author: Practitioners Publishing Corporation  
Publisher: Practitioners Publishing Corporation, 2001

A thorough discussion of all the issues related to nonprofit accounting. Useful for bookkeepers as well as other people in the organization.

**Not-for-Profit Accounting Field Guide**

Author: Larkin, Richard F. and Marie DiTommaso  
Publisher: Wiley & Sons, 2003  
ISBN: 0471264911

A quick reference to the unique accounting and financial reporting issues affecting nonprofits.

**Not-for-Profit Accounting Made Easy**

Author: Ruppel, Warren, 2002  
ISBN: 0471206792

Suitable for anyone who needs to read and understand a not-for-profit financial statement - this is *the* not-an-accountants guide to not-for-profit accounting.

**Not-for-Profit Budgeting and Financial Management**

Author: McMillan, Edward  
Publisher: Wiley, 2003  
ISBN: 0471453145

The author's continuous budgeting system is easy to use and monitor and ensures true fiscal accountability. The system enables nonprofits to create reasonable financial plans that fit their organization's needs.

### **Presenting Nonprofit Financials: An Overview of Board Fiduciary Responsibility**

Author: McLaughlin, Thomas A.

Publisher: National Center for Nonprofit Boards, 2001

ISBN: 1586860283

This CD-ROM and guidebook aims to familiarize Board members with the financial information they need. Gives an overview of the lines of responsibility within the organization and an understanding of how to assess a nonprofit's financial health.

### **The Practical Guide to Managing Nonprofit Assets**

Author: Schneider, William A., Di Meo, Robert A. and Michael S. Benoit

Publisher: Wiley, 2005

ISBN: 0471692236

Explores phases of investment processes—fundraising challenges; special issues facing hospitals, colleges, & religious orders; spending policies; investment theories; fiduciary issues and roles & responsibilities of various providers/vendors to the fund.

### **Understanding Nonprofit Financial Statements**

Author: Berger, Steven.

Publisher: BoardSource, 2003

ISBN: 1586860534

Help motivate and involve your Board members to become active fundraisers. Use the accompanying Fundraising Checklist to create successful development strategies and build Board members fundraising skills.



The information and materials contained within this handbook and the Financial Fitness series are designed to assist individuals in the key management and Board roles within most not-for-profit organizations. *Accounting Athletics, Financial Fitness* and *Legal Limberness* will help organizations move themselves further along the curve of understanding what it takes to be healthy, financially strong and stable organizations.

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