

Understanding Financial Statements

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Today's objective

To help you understand not-for-profit organizations (NPO) financial reporting to be able to perform the financial oversight aspects of your board or management role

ASNPO Methods

There are two financial statement presentations available in ASNPO:

- Deferral method
- Restricted fund method

AFHTO uses the deferral method: the financial statements, especially the **Surplus/Deficit (net income)**, are usually dramatically different under each method

ASNPO – Why are they different?

Different approach to acknowledging grant/donation/other receipts that are subject to spending restrictions imposed by the contributor.

Deferral method – Recognize revenue when restrictions have been met.

Usually when spent on the restricted purpose or when a class or event has occurred.

Restricted fund method – Set up fund columns for the classes of restriction, then recognize as revenue when received in the column tied to the restriction.

There is limited space on financial statements for columns. If there is no column for the restriction, the revenue would be recorded in the same manner as the deferral method

Some key concepts in Financial Reporting

Estimates

Financial statements deal with matters which can be inherently uncertain.

Cash basis accounting is not ASNPO.

Estimates can be required.

Examples

Amortization expense – the rate chosen is meant to approximate the useful life of the asset.

Accrued liabilities – costs are often incurred before precise invoices are received, thus estimates come into play at each period end

Allowance for bad debts – adjustment from estimating the collectability of receivables

Contingent liabilities – estimates to calculate the probable cost of a liability once it becomes likely (for example a legal case)

Estimates

Accrual basis versus cash basis of accounting:

Accrual basis – recognize revenues and expenditures in the period it is earned or incurred

Cash basis - recognize revenues and expenditures at the time cash is actually received or paid

The only method permitted under Generally Accepted Accounting Principles is accrual basis

Asset Liabilities

Asset definition

A resource controlled by the entity as a result of past events and from which probable future economic benefits are expected to flow to the entity.

Liability definition

A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity resources embodying economic benefits.

Note Disclosures

- Discloses information on balances in the financials in accordance with the accounting standards
- Gives the reader of the financials further details on the information presented in the statements

The objective of the notes is not to provide management commentary or analysis.

Subsequent events

Information after the year end can affect the financial statements

- Some kinds of events provide additional evidence about the conditions that existed as of the report date. The financial statements should be revised to factor in this information.
- Some events after year end (like a premise fire), if known could have a dramatic impact on how the financial statements are read and decisions are made.

**These events require note disclosure.

Jumping into sample financial statements

Revenue

Revenue

Ministry of Health and Long-Term Care grants	\$ 4,859,532	\$ 4,717,264
Recognition of deferred contributions - property and equipment	191,283	205,134
Interest and other	2,345	631
	<u>5,053,160</u>	<u>4,923,029</u>

Grant revenue

- Do we understand the conditions involved with these grants?
- If we have to return unspent funds, do we have a clear back-up plan for additional purchases if our budgeted activities run under budget?
- Grant revenue can be lumpy and lead to irregular cash in-flows and out-flows. Have we thought about the timing of the grant revenue receipts in our spending decisions?

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Deferred capital contributions

- Difference between cash accounting and ASNPO.
- Grants used to purchase capital assets are recognized as the net book value of the asset that was purchased is reduced with amortization.

Expenses

Expenditures

Salaries and wages	3,375,783	3,371,002
Employee benefits	716,975	707,225
Rent	312,782	318,464
Amortization	191,283	205,134
Administration support	148,547	147,408
Consulting	132,900	112,563
Staff development and travel	42,422	58,856
Insurance	27,627	28,230
Professional fees	27,443	19,809
Clinical programs support	13,029	9,044
	<u>4,988,791</u>	<u>4,977,735</u>

Assessment of the expenses will be different depending on the relative revenue directly tied to incurring the expenses.

Salaries and benefits:

- How much is the change in salaries and benefits tied to specific grant and project revenues?

Allowable expenses versus budget; is there any flexibility?

Changes in Net Assets:

Deficiency, beginning of year	\$ (114,878)	\$ (60,172)
Excess (deficiency) of revenue over expenditures	<u>64,369</u>	<u>(54,706)</u>
Deficiency, end of year	<u>\$ (50,509)</u>	<u>\$ (114,878)</u>

Surplus Repayable to MOHLTC

- This happens when the Organization doesn't spend all that it can on the costs allowed for in the Ministry grant.
- Some complexity is added by HST rules for NPOs receiving more than 30% government funding
 - HST Public Service Rebate recovery is 69.69% of the HST on vendor invoices. Thus the invoiced amount + about 30% of the HST counts as an expense in the grant spending calculation.

Assets

Assets

Current

Cash and cash equivalents (Note 4)	\$ 366,013	\$ 263,817
Accounts receivable	88,111	46,043
Prepaid expenses	<u>12,987</u>	<u>10,416</u>
	467,111	320,276
Property and equipment (Note 6)	<u>197,892</u>	<u>383,250</u>
	<u>\$ 665,003</u>	<u>\$ 703,526</u>

Investments

- Do you understand the investment policy of the Organization?
- Assess the cash and investment lines together to consider cash flow changes in the year.

Accounts Receivable

- How old is it?
- Do we have policies to follow before providing credit or continuing to provide credit?

Prepaid expenses

- Can fluctuate - depending on the timing of payment processing functions and of the nature of operations (activities typically requiring a deposit before the work or service).

Assets

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\$ 665,003 \$ 703,526

Capital Assets

- Any large capital asset purchases or sales should be approved before being purchased
- Challenge your expectations of capital purchases from budgeting and project discussions versus what has been recorded.

Liabilities

Liabilities

Current

Accounts payable and accrued liabilities	\$ 433,080	\$ 429,904
Due to Ministry of Health and Long-Term Care (MOHLTC) (Note 7)	82,490	-
Deferred contributions (Note 8)	<u>2,050</u>	<u>5,250</u>
	517,620	435,154
Deferred contributions - property and equipment (Note 8)	<u>197,892</u>	<u>383,250</u>

Accounts payable and accrued liabilities

- Normal to fluctuate – depends in part on the timing that the accounting team processes

Due to Ministry of Health and Long-Term Care

- This balance is a function of how slow the Ministry is to process the year end reports that calculate the amount owing. Once processed, the Ministry will request the repayment.

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Deferred contributions

- Cash received before the grant period that it relates to.

Deferred Capital Contributions

- Will match the net book value of assets purchased with grant funds that are specifically for capital asset purchases.
- Adjustments in this category are typically done annually rather than monthly.

Review of financial reports at Board meetings throughout the year

Tips and traps

Role of the Board

When reviewing internal financial reports

- Best practice reporting is “exception” based
- Attention is paid in variances in expectations
- Meeting time should not be not taken up with reporting “we are on track”, although this information is provided

Role of the Board

Reviewing internal financial reports

When (if ever) should budgets be revisited?

- Avoid changing budgets mid-year
- Instead, require an explanation on reports for why the actual costs are substantially different than budgeted
 - This will highlight the issue
 - This will provide an opportunity to document how the variance will be funded
 - This will provide an opportunity to talk about the longer term impact of this variance (is this a new trend?)

Role of the Board

Reviewing internal financial reports

Lookout for financial statement **relationships**

Internal controls best practices

*Board Literacy for understanding common
internal control weaknesses and impacts*

Role of the Board

Importance of Internal Controls in financial reporting

Internal controls - support reliable financial reporting.

Effective control environment has a good mix of control types:

- Foundational, operational, or monitoring
- Automated or manual
- Preventive or detective

Considerations with Internal Controls Common Control Weaknesses

Segregation of duties weaknesses exist when:

One person...

- opens cash or cheque donations alone
- makes the bank deposit and has access to the general ledger
- prepares cheques, has journal entry access, and mails the cheques out once signed
- sends and receives payroll information from a 3rd party provider
- Creates manual journal entries with no secondary review of these entries

Considerations with Internal Controls Common Control Weaknesses

Journal entry policies and procedures weaknesses can exist when:

- access rights are not limited based on user role
- individuals can initiate and post journal entries with no secondary review
- individual in financial reporting oversight has access to make journal entries
- no formal review of non-standard journal entries and/or indication of review
- individuals in a financial reporting role have IT admin access (super user access)

Considerations with Internal Controls Common Control Weaknesses

Other

- No formal whistleblower policy
- Approval of expense reports
- Approval of corporate credit card information
- Bank reconciliations review
- Evidence of review
- No conflict of interest statements

Financial reporting non-for-profit trends

Focus on metrics

More and more grant providers and the government are requesting non-financial metrics to measure success.

- Participant feedback
- # of patients
- New patients
- Particular health improvements
- Visits by a specific type

Opportunity? NPOs can show outcomes of their work.

Challenge? Tracking this information takes pre-planning and growing admin time.

Thank you

Questions

Thank you!



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