

Review of Financial Statements

Of Not-for-Profit Organizations

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BDO Dunwoody LLP
Chartered Accountants
and Advisors

Overview

- Purpose of annual financial statements
- Why do I need to understand financial statements?
- What type of information can be obtained from the financial statements?



Presenters

- BDO Dunwoody LLP
 - Experience working with many not-for-profit organizations
- Bill Cox, CA, Partner
- Dawn Wedman, CMA, Manager



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Financial Statement Components

- Statement of Financial Position (Balance Sheet)
- Statement of Operations (Income Statement)
- Statement of Changes in Net Assets
- Statement of Cash Flows
- Significant Accounting Policies
- Notes to the Financial Statements
- Supplementary Schedules



Statement of Financial Position

- Assets
 - Main types and examples
- Liabilities
 - Main types and examples
 - Deferred revenue – will come back to this
- Net Assets
 - Area that differs most for NPOs as compared to “regular” businesses



Net Assets

- Organizations net available if paid off all liabilities
- Invested in capital assets
 - Locked up, not available
- Externally restricted
 - Only used for specific purposes
- Internally restricted
 - Set aside for a purpose
 - But Board can use for any purpose
- Available
 - “free and clear” money



Level of Surplus

- Internally restricted net assets plus net assets available equals an organization's surplus funds
- Surplus is not a dirty word
 - Working capital is necessary to run any organization
 - 3 to 6 months of committed operating expenditures is reasonable level
 - Large portion of surplus may have come from fundraising or other internally generated monies, not necessarily contract funding
- Low or negative surplus indicative of significant financial concern



Current/Non-Current Distinction

- Concept of current – items that will be maturing/payable within next business cycle (usually one year)
- Working capital/working capital ratio
- What to look for

Statement of Operations

- Statement of Financial Position is a snapshot at point in time (fiscal year-end)
- Statement of Operations shows results for the fiscal year
- Many different looks
 - See samples
 - Funds vs. consolidated



Items to watch for on Statements of Operations

- Net results from programs
 - Especially your funded programs
 - Positive or negative
 - Allocation of admin/overhead costs
- Non-cash expenses (eg. Amortization)
- All costs/revenues included?
 - Should be
 - Statement of Changes in Net Assets
- Interfund transfers
 - Before bottom line?
 - Needed for balancing or taking away surplus
- Prior year comparisons
- Budget information (if provided)
- Results from fund-raising and own sources



Statement of Changes in Net Assets

- Purpose
- Allocation of net results between funds
- Interfund transfers
- Prior year comparisons



Statement of Cash Flows

- Purpose
- Cash transactions only
- Three sections
 - Importance of operating results
 - Watch financing section



Accounting Policies

- Mostly accounting theory related and not of great importance to non-accountants
- Items to watch for
 - Restricted fund vs. deferral accounting basis
 - Revenue recognition policies
 - Reporting entity – subsidiaries etc.
 - Cash vs. accrual (cash is non-GAAP)



Notes to Financial Statements

- Further information in regard to items presented on Statement of Financial Position or Statement of Operations
- Items to watch for
 - Related party transactions
 - Commitments
 - Contingencies



Schedules to Financial Statements

- Supporting and supplementary information
- Generally no prescribed information requirements or format requirements – can be quite varied
- Maybe information by program
- Can be information required/requested by funders



Walk through a few sample financial statements

- Several variations
- Restricted fund vs. deferral for SAME information to show differences



Deferred revenues

- Basic theory
- Difficulty in tying in cash basis
- Deferred revenue from programs vs. deferred capital contributions



Deferred revenue – why?

- “Matching” concept
- If don't do would seriously misrepresent financial position
 - Example
- When percentage of completion concept would not be followed (loss contract)



Deferred revenue – reconciling funding

- Almost impossible to reconcile your funding on a cash basis to amounts reported in financial statements in most cases
- If necessary
 - Statement of operations concept showing actual funding and change in deferral (sample)
 - Schedule to reconcile (sample)



Levels of Verification

- Notice to Reader
 - Not necessarily independent
 - No verification but can not be knowingly wrong
- Review Engagement
 - Comparisons and discussion
 - GAAP statements
- Audit
 - Highest format
 - Testing, systems review, confirmations
 - GAAP statements
 - Audits also produce management letters



Costs of different Verification Services

- Notice to Reader
 - Generally quite low
 - “Average” NPO – range \$500 to \$2,000
- Review Engagement
 - Same financial statements and notes as an audit would produce, so substantial time ensuring compliance with GAAP
 - “Average” NPO – range \$2,000 to \$15,000
- Audit
 - Review engagement procedures plus external verification procedures
 - “Average” NPO – range \$5,000 to \$25,000



Items to Watch in Assessing Quality of Verification

- Statements usually prepared by external accountants, so typos, mis-references, and obvious poor quality hard copy can be an indication
- Any size firm can be good, but generally can be assured that the large firms will do a good job: BDO Dunwoody, Deloitte & Touche, Ernst & Young, PWC, KPMG, Grant Thornton
- Quality of management letters received can also be an indication
- Can call Institute of Chartered Accountants of British Columbia for questions or references



Management Letters

- Not directly part of audit, but rather a byproduct
- Points that come to the auditors attention while doing work
- Typical points relate to internal control deficiencies or operational issues
- Definitely worth review when evaluating financial health of an organization



Summary of Items to Look For in Review of Financial Statements

- Type of Report and by Whom
 - Audit vs Review vs NTR (Audit best, NTR almost worthless)
 - Has there been a change in auditors
- Statement of Financial Position
 - Liquidity
 - Cash in bank, change in cash levels
 - Investments
 - Working capital ratio
 - Debt levels
 - Level of Net Assets
 - Most important is internally restricted plus available
 - Change from prior year



Summary of Items to Look for in Review of Financial Stmts (cont)

- Statement of Operations
 - Are programs self-funding?
 - Degree of reliance on fund-raising (and comparison to prior year(s))
 - Level of administrative expenses (and as a percentage of total expenses)
 - Level of salaries, rents and other expenses that can not be easily reduced
 - Ensure no transfers to or from other funds



Summary of Items to Look for in Review of Financial Stmts (cont)

- Statement of Cash Flows
 - Are operations returning positive cash flow
 - Degree of debt issued – for specific purpose (i.e. acquiring needed asset) or funding operations?
 - Overall cash balances



Summary of Items to Look for in Review of Financial Stmts (cont)

- Notes to Financial Statements
 - Commitments – can organization afford, how will they be funded
 - Contingencies – lawsuits or other items that could hurt organization's finances
 - Related party transactions – are members or officers benefiting or acting inappropriately in dealings with organization
 - Continued Operations – auditors may note that the organization is in serious financial health
 - Economic Dependence – do auditors feel that organization is dependent upon you and/or other funders



Questions that you Might Ask of Management

- Actions taken to rectify items mentioned in the management letter
- Explanation of items noted such as contingencies, commitments and related party transactions and updated status of same
- Qualifications of accounting staff and whether turnover in key financial positions
- Others
- Others from group



Contact BDO

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