HOW TO READ FINANCIAL REPORTS

Financial reports, usually produced on a regularly scheduled basis, provide the opportunity for both management and board members to review an organization's financial position.

Responsibility for an organization's financial reporting is shared by management, the board and an external auditor. Management is responsible for preparing financial reports and developing internal financial controls; the board is responsible for overseeing management's financial reporting processes and ensuring reporting exists to satisfy itself and external stakeholders; and the auditor is responsible for making an independent assessment of the financial statements and giving a professional opinion on whether they give a fair representation of the organization's financial position.

While all three have different responsibilities in the process, board members may have the least experience in analyzing financial reporting. While not every financial report is set up exactly the same, there are some key statements board members should be familiar with, and questions they can ask to clarify their understanding an organization's financial health.

KEY CONCEPTS TO KNOW

Key Accounting Terms

There is a glossary of terms used in accounting that board members should know, such as assets, liabilities, revenues, expenditures, accounts receivable, accounts payable, net assets, net revenue, contributions, working capital, etc. *(A glossary of terms can be found at the end of this section.)*

Time Frame

All reporting is based on a time frame, which is different for different reports. Keep in mind, there is a difference between figures presented "at a point in time" – (those figures calculated on a particular date, such as assets, liabilities and net assets); and figures presented as "cumulative sums over time" – (the total financial value of an activity during a fixed period of time, such as revenues and expenditures).

TWO KEY FINANCIAL STATEMENTS

According to the Chartered Professional Accountants of Canada, there are two key financial statements board members should review on a regular basis, as part of the budgeting process, monitoring of results, or review of the auditor's financial statements: the **Statement of Operations** and the **Statement of Financial Position**.

Statement of Operations

The Statement of Operations, or income statement, summarizes revenues and expenditures over a period of time. It also shows the net balance (in excess or deficit) of revenues over expenditures.

REVENUES – EXPENSES = EXCESS (OR DEFICIENCY) OF REVENUES OVER EXPENDITURES
(also known as NET INCOME)

Revenues are the source of funds coming into the organization. Expenditures are the costs of doing business of the organization. Revenues and expenditures are organized in various categories (determined by the organization) usually ranked from largest to smallest.

Non-profit organizations are expected to spend whatever revenues are generated on program delivery – they are not expected to have a profit. However, a small operating surplus, to buffer against unforeseen eventualities, is not unreasonable.

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	Current Year $000	Previous Year $000
Revenues		
Government Grants	1,500	1,200
Foundation Grants	900	900
Program Fees	850	650
Contributions	350	550
Investment Income	150	120
Interest and Other	10	15
Amortization of Deferred Contributions	12	15
Total Revenues	3,772	3,450
Expenditures		
Salaries and Benefits	1,550	1,400
Rent	1,275	1,000
Office	890	900
Amortization of Capital Assets	25	25
Total Expenditures	3,740	3,325
Excess of Revenues Over Expenditures	32	125

Questions Board Members May Ask:

The first thing board members should do is **compare the figures for the current year to the previous year**. There may be changes over time that raise questions. The Chartered Professional Accountants of Canada (2012), recommends some additional questions when considering revenues and expenditures:

- Who provides each category of revenue to the organization and why? Are there restrictions on how these revenues are used?
- What are the costs associated with raising this kind of revenue? Is it worthwhile?
- What are our fundraising expenditures as a percentage of funds raised?
- Who are our competitors/collaborators for these revenues?
- Have we remained true to our mission in acquiring these revenues?
- Are there revenues devoted for a specific program, project or activity? Do they contribute to overhead?
- How secure is this revenue for future periods?
- What is the source of investment income? What is our target return on investments? Is this achievable in the current economic climate?

- What is included in other income, other revenues, or other expenses? Should any of these components be reported separately?
- What lies behind the expenditures on salaries and benefits? When did we last award raises and when is the next scheduled? What benefits do we provide our employees and what is the cost? How do we handle vacations and vacation pay? How does our compensation stack up in the marketplace?
- What spaces do we rent (or own)? Are they sufficient? What are the major lease/rental terms? How long until we have to move or negotiate a new lease?
- What is the policy for amortization of capital assets?

When reviewing the Statement of Operations, board members may use some formulas for calculating changes from year to year. *(See formulas at end of section.)*

- % TOTAL REVENUES OVER REVENUE SOURCE

Statement of Financial Position

The Statement of Financial Position, sometimes called a Balance Sheet, demonstrates the organization's financial position at a particular point in time. This report shows how the Total Assets equal the Sum of Total Liabilities and Net Assets.

TOTAL ASSETS	**=**	**NET ASSETS + TOTAL LIABILITIES**
NET ASSETS	**=**	**TOTAL ASSETS – TOTAL LIABILITIES**

The Statement of Financial Position organizes assets and liabilities based on how close each is to cash.

- Current Assets – available or easily available cash
- Current Liabilities – need to be paid in current year
- Long Term or "Fixed" Assets – not expected to become cash until future year
- Long-Term Liabilities – not expected to require payment within the next year

Most organizations will normally have more assets than liabilities. What is left over is shown as the balance or Net Assets, which is the net worth of the organization.

Example of Statement of Financial Position

Organization Name
As of December 31, 20XX

	Current Year $000	Previous Year $000
Assets		
Current Assets		
Cash and Cash Equivalents	570	500
Grants Receivable	100	55
Accounts Receivable	25	20
Prepaid Expenses	32	32
	727	607
Investments	200	200
Capital Assets (Property & Equipment)	528	550
	1,455	1,357
Liabilities and Net Assets		
Current Liabilities		
Bank Indebtedness	75	75
Accounts Payable	125	115
Current Mortgage Payable	55	55
	255	245
Mortgage Payable	225	300
Other	5	10
	230	310
Deferred Contributions	75	50
Deferred Contributions – Capital Assets	43	35
	118	85
Net Assets		
Net Assets Restricted for Endowments	70	50
Net Assets Invested in Capital Assets	85	40
Net Assets Internally Restricted for Sp. Projects	30	15
Unrestricted Net Assets	667	612
	852	717
	1,455	1,357

Questions Board Members May Ask:

Once again, board members should begin by comparing the figures for the current year, compared to the previous year in the Statement of Financial Position. The Chartered Professional Accountants of Canada (2012), recommends some additional questions:

- What are the components of cash and cash equivalents? Are any of these at risk of losing value?
- Who owes us the accounts receivable? What is the age profile of these accounts? Is there likely to be a problem collecting these amounts? Has any provision been taken for uncollectable amounts?
- What are the components of prepaid expenses? Do we have any choice about paying in advance?
- What are the major types of invested assets we hold? Do we have an investment policy? What are the risks associated with these types of investments?
- What are the capital assets we own? Where in the organization are they used? How are these assets depreciated or amortized? Do we have plans to replace these assets as needed?
- To whom do we owe accounts payable? Do we pay these amounts on a timely basis?
- What is the renewal date for the mortgages or loans outstanding? What is the interest rates? Is it still considered a good rate? Is cash available to pay down the loan sooner?
- What is included in other liabilities? To whom are these owed and why? Do we have the cash resources to pay them?

When reviewing the Statement of Financial Position, board members may use some formulas for calculating changes from year to year. *(See the chart at the end of this section for these formulas.)*

- WORKING CAPITAL RATIO
- PERCENTAGE CHANGE OF INVESTED ASSETS
- PERCENTAGE CHANGE IN CAPITAL ASSETS

The Statement of Operations and the Statement of Financial Position are linked. The investment income shown on the Statement of Operations is linked to the size of return on investment assets shown in the Statement of Financial Position.

OTHER STATEMENTS TO CONSIDER

Depending on the area of interest, there are other financial reports that provide useful information about the organization's finances.

Statement of Cash Flows

The Statement of Cash Flows shows an organization's generation and use of cash over a specified time period. It is made up of cash receipts and payments that arise from business set up by principal categories and uses.

Notes to Financial Statements

Notes to financial statements are additional information provided with the organization's financial statements, which include: income statement, balance sheet and statement of cash flows. These notes are important disclosures that further explain the numbers in the financial reporting.

REGULAR FINANCIAL REVIEWS

Both management and the board should be reviewing financials on a regular basis. Management should create an environment where the board can ask enough questions. All board members should feel comfortable enough to ask questions as needed. However, it is important that questions are answered and then quickly return to the board level to assess the issue from the strategic level.

Many boards develop a set of dashboard indicators that can be updated by management. When reviewed on a regular basis, these indicators help focus monitoring efforts.

KEY RESOURCES TO HELP ANALYZE

Ratios to Help Analyze Financial Statements

PROFITABILITY RATIOS	FORMULA (The symbol " / " means to divide)
Gross Profit Margin	Gross Profit / Net Revenue
Profit Margin	Net Income / Net Revenue
Markup Ratio	(Gross Fee Revenue + Other Fee Revenue) / Operating Expenses
Cost to Charge Ratio	Average Cost of Services / Average Price of Services
Operating Margin Ratio	Net Operating Income / Total Operating Revenue
Net Working Capital	Current Assets – Current Liabilities
Current Ratio	Current Assets / Current Liabilities

LEVERAGE RATIOS	FORMULA
Debt Ratio	Total Liabilities / Total Assets
Debt Equity Ratio	Total Liabilities / Retained Earnings
Equity Financial Ratio	Fund Balance / Total Assets
Fixed Asset Financial Ratio	Long-Term Debt / Net Fixed Assets

ACTIVITY RATIO	FORMULA
Total Asset Turnover Ratio	Total Operating Revenue / Total Assets
Fixed Asset Turnover Ratio	Total Operating Revenue / Net Fixed Assets
Current Asset Turnover Ratio	Total Operating Revenue / Current Assets
Revenue Ratio	Total Revenue / Revenue Source
Of Invested Assets	Earned on Investment – Initial Investment / Initial Investment

Glossary of Terms

TERM	DEFINITION
Accounting Policies	Specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
Accounts Payable	Amounts owed by an organization.
Accrual Accounting	Transactions recorded when they occur, regardless of when money actually changes hands between the organization and third parties.
Amortization	The writing off of the cost of an asset, less any residual value, in a rational and systematic manner over its useful life.
Assets	Possessions having value, such as resources owned or controlled by an individual or organization as a result of transactions or events from which future economic benefits are expected.
Capital Assets	Tangible and intangible properties that are: held for use in the provision of services, for administrative purposes, for production of goods or for the maintenance, repair, development or construction of other capital assets; have been acquired, constructed or developed with the intention of being used on a continuing basis; and are not intended for sale in the ordinary course of

	operations.
Cash Accounting	Transactions recorded only when there is an exchange of cash.
Contributions	Non-reciprocal transfers to a not-for-profit organization of cash or other assets or non-reciprocal settlements or cancellations of its liabilities. Government funding to a non-profit is considered a contribution.
Current Assets	Assets that are in the form of cash, or expected to become cash within the coming year.
Current Liabilities	Obligations that have to be paid within the coming year.
Deferral Method	Restricted contributions related to expenses of future periods are deferred and recognized as revenue in the period in which the related expenses are incurred.
Deferred Contribution	Restricted contribution received or recorded as receivable but carried forward to be taken into income in future periods as the related restrictions are met.
Expenditures/Expenses	Decreases in economic resources, either by way of outflows or reductions of assets or incurrences of liabilities, resulting from an entity's ordinary activities.
Fair value	The amount of the consideration that would be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act.
Fiscal Year	The twelve month period designated by the organization for its "business year".
Fund Accounting	The collective accounting procedures resulting in a self-balancing set of accounts for each fund established by legal, contractual or voluntary actions of an organization.
General Fund	Self-balancing set of accounts which, under the restricted fund method of accounting for contributions, reports all unrestricted revenue and restricted contributions for which no corresponding restricted fund is presented. The fund balance represents net assets that are not subject to externally imposed restrictions.
Liabilities	A synonym for debt, represents amounts that it is expected will require settlement in the future as a result of events and transactions that occurred prior to the accounting date or obligations for future delivery of goods or services for which payment has already been received.
Materiality	The reasonable prospect of an item or items being significant to financial statement users in making decisions.
Net Assets	The residual interest in a non-profit organization's assets after deducting its liabilities. May include both restricted or unrestricted and is sometimes referred to as equity or fund balances.
Note Disclosure	Explanatory or supplementary information that elaborates on data summarized in the main body of the financial statements or provides additional information that is important to understanding the situation being reflected in the statements.
Restricted Contribution	Contribution subject to externally imposed stipulations that specify the purpose for which the contributed asset is to be used.
Restricted Fund	A self-balancing set of accounts, the elements of which are restricted or relate to the use of restricted resources.
Restricted Fund Method	Includes the reporting details of contributions on financial statements by fund, in such a way that the organization reports total general fund, one or more restricted funds and an endowment fund, if applicable.
Restrictions	Stipulations imposed that specify how resources must be used. Restrictions on contributions may only be externally imposed. Internally restricted net assets or fund balances are often referred to as "reserves" or "appropriations".
Revenues	Increases in economic resources, either by way of inflows or enhancements of assets or reductions of liabilities, resulting from the ordinary activities of an

	entity.

Other Topics to Explore:
Financial Audit
Audit Committees
Financial Planning aka Budgeting
Financial Policies

On-Site Materials
Sample SaskCulture Policies

Other links:
A Guide to Financial Statements for Not-for-Profit Organizations: Questions for Directors to Ask, by Chartered Professional Accountants of Canada, 2012. ($15)

Canadian Revenue Agency Checklists.

Basic Overview of U.S. Nonprofit Financial Management, by Carter McNamara, MBA, PhD. Authenticity Consulting, Copyright 1997-2008.

Keeping the Record Straight: Introductory Accounting for Non-Profit Organizations. Certified General Accountants of Ontario, 2012.

New Accounting Standards for Charities and Non-Profits. WEBINAR. Imagine Canada, 2012.