July 2013 Newsletter

This Issue

CCA is good for your finances – As if you didn't know
Reserves – How much is enough? And how much is too much?
Umbrella Issues – If you're umbrellaing another group, you'll better stay out of the rain.

Coming Up

23 October 2013: Community Law & CCA Workshop: Reading and Understanding Financial Documents. 7-9 pm.
Targeted at Board members. Already almost full, but if overbooked there might be a second workshop.
Register via Community Law Centre, 0508 CANLAW or by emailing susan@canlaw.org.nz

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CCA Saves U $$$$

In the last year, CCA has saved community groups about $25,000 in direct expenditure, based on the records that we have about our clients' previous audit costs and accounting fees. This is a fairly conservative estimate, made up of about $15,000 in saved audit/review costs, $5,000 in previously paid fees for creating financial statements and other services, and another $5,000 in recovered IRD penalties, overpaid GST or other accounting mistakes to your disadvantage that we discovered.

The indirect benefits are harder to quantify, and I am not going to try. They consist of better financial management and information, systematic errors being eliminated, less admin and Board time spent on sorting out pesky accounting details, having access to people who actually understand not-for-profits, upskilling admin staff and Boards and, in some cases, quite enormous relief of having these things being taken care of.

Our client roll has passed the 70 mark now, and on average one new organisation per week is requesting our services. The word seems to be spreading in North Canterbury as we are picking up more and more clients there.

Of our clients, a third have income of less than $10,000, a quarter are in the $10 – 50,000 bracket, another third is between $50,000 and $200,000 and the remainder (6%) are over $200,000. This is very much in keeping with our mission to support especially the smaller entities, for which accounting services and audits would otherwise simply not be available at a reasonable price. 80 % of our clients receive conditional grants or government income for which they are accountable. About a quarter each are from the social services and neighbourhood/community sectors, 10% each from Health and Education sectors, and the last quarter is about evenly made up of Arts, Cultural, Environment and Sports organisations.

I think this is an impressive record

In other news, some of you will have met **Yvette,** legally known as Yu Zeng, in workshops or while popping in here. She has helped with many audits over the last nine months or so as well as creating financial statements and some other odd jobs (such as fixing your payroll mistakes). She has now been employed with us for a few hours each week as an administrator, which is mainly about looking after our own administrative requirements, but she will also look after payroll clients.

We have also taken on two new young interns, both CPIT Graduate Diploma in Accounting students. These are Chen Yue (known to us as **Vivienne**) and **Abhishek** Shrestha. With our current workload the extra hands are more than a little appreciated.

Harald

Reserves – How Much Should You Have?

Community organisations that depend on funding operate in an uncertain environment. Where for a business sales may decline or rise this rarely happens overnight. But a not-for-profit can be cut off from a significant funding source pretty much without notice. Multi-year funding agreements are thin on the ground, and reliable forecasts are difficult to make. To be able to stomach a sudden funding cut, an organisations needs to have some reserves. However, too much reserves and funders start asking why you aren't using them.

This is a contentious issue. Some organisations are not able to build up any reserves because all their income is 'tagged' by funders and has to be spent within a year. Others are able to generate significant donation income from the public, which is untagged, and are able to build up so many reserves that they are able to live on investment proceeds without asking for any more. The first is risky, the second possibly unethical.

Depending a little bit on how spread out funding is over the year for a particular organisation, reserves should be sufficient to cover expenditure for at least about 6-9 months, preferably 1-1.5 years.

Some organisations have reserves in the form of investments (term deposits or other) that are multiple times their annual expenditure, and some are indeed trying to live entirely off investment income in order to be independent from funders. This may be problematic.

It depends on how the reserves were built. If they are made up mostly out of large donations such as bequests, perhaps given with the intention to create ongoing independent income, then there is no problem with it. If they were built from donations from the general public with the implied message that they are put towards a certain cause, then the accumulation of such funds may be legal but not ethical. If you donate towards a certain cause you do not normally intend this money to go towards buying investment property to ensure future income. And should a large part of your membership subscription to your local sports club go into accumulating equity so that the club can continue to exist even if it no longer has any members?

The problem with investment income for not-for-profits is exactly that there is no scrutiny over it. Once you have built up enough reserves so that your organisation can live on investment income alone, you no longer have to have anything to show for your efforts, and you don't lose your income even if, for example, your cause has become obsolete or even contra-productive. Some large not-for-profits with high-profile fundraising campaigns in New Zealand put a significant amount of publicly raised funds into investments, not to the purpose people believe they donated for.

If you donate to such causes, you may want to check the organisation's financial statements on the Charities web site (they're all public). You do not need to be an accountant to be able to compare the equity (accumulated funds) figure with the organisation's annual expenditure, or to see how much of the donations received ever made it into provision of services.

Umbrella Issues

Many organisations 'umbrella' other organisations or initiatives to help them get started or because these smaller groups do not want to have the hassle of all the legal paperwork. We often find the funds of these smaller groups in the liability (or sometimes equity) section of the accounts of the larger organisation as 'funds held on behalf' or some such. That's actually the wrong place for them.

If a small group uses the incorporation and registration documents of another to operate, then their operations become part of the umbrella groups' operations. The umbrella group is usually legally responsible for any funding agreements and liabilities arising from the smaller group's activities, and any funds coming in from those activities belong to the umbrella group.

Ideally there should be an umbrella agreement specifying either party's roles and responsibilities. We think that key features of this should be:

- What conditions must be met for the umbrella group to release any requested funds,
- What conditions must be met for the umbrella group to sign their name to any funding application,
- How the smaller group reports to the umbrella group's management or governance board,
- Who controls the funds on a day-to-day basis.

For accounting, the activities of the smaller group are part of the umbrella group's income and expenditure, and any assets bought or liabilities incurred belong to the umbrella group. They can be (but don't have to be) disclosed separately in the Financial Statements in a number of ways.

An auditor will also have to look at the activities of the smaller group and, if no financial documentation is available, will probably put a qualifier in the audit report which leaves a little question mark on the umbrella organisation's finances.

Umbrellas are a good way to get new initiatives started and fostered, but the umbrella organisation needs to be aware that it is probably responsible for anything going wrong.