September 2013 Newsletter

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New Audit Bill – Chartered Accountants bag exclusive rights to a new statutory NFP audit market.
Workload Update – Making Progress.
Capital Grants and the Income Statement – Constructing a building may make you look rich to funders.
Using Financial Statements – They're an important decision-making tool.
Need an administrator? – This one may be just the ticket.

Coming Up

22 October 2013: Aspire Workshop: Administering Not-For-Profits with Confidence. 1-4 pm. Targeted at administrators especially of small not-for-profits. Register through Carolynn Hull, mail@justdollars.org.nz
23 October 2013: Community Law & CCA Workshop: Reading and Understanding Financial Documents. 7-9 pm. Targeted at Board members. Register via Community Law Centre, 0508 CANLAW or by emailing susan@canlaw.org.nz

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'Qualified' Accountants Get Monopoly on NFP Audits.

The requirement for not-for-profits with more than $500,000 in operating expenditure per year to employ a 'qualified' accountant for a 'review' or audit is now almost certain to become law after Cabinet has approved it. This will come into force first for financial years ending 31 March 2016. 'Qualified' probably does not refer to the legal definition (**all** accountants have to be qualified by law) but to members of professional organisations such as the NZ Institute of Chartered Accountants or CPA Australia, although the Cabinet paper is silent on this.

I am in favour of requiring audits (or something like it) for larger not-for-profits, and I don't think that there are many, if any, of that size that aren't getting one done at the moment. However, I would have liked to see some not-for-profit qualification or experience being required of auditors (neither NZICA nor CPA require this of their members). Too many of them simply haven't got a clue about grant accounting, and what does and doesn't constitute a liability. Sometimes this can have devastating consequences: I have seen some accounts prepared by professional accountants this year that showed negative equity because of incorrectly stated liabilities. Negative equity is an absolute showstopper for funders as it means they would be financing debt rather than fund new activity.

I am always amazed by how clued-up most smaller groups are about the accounting side of things, though. Businesses of similar size very, very rarely produce financial information of similar quality and don't have such a good grasp on where they're standing. Personally, I find that organisation-created Financial Statements are also generally more readable, meaningful and (in context) accurate than where a professional accountant is used to do them. Creating your own financial information provides a huge advantage, because the process makes you look at the numbers!

Harald

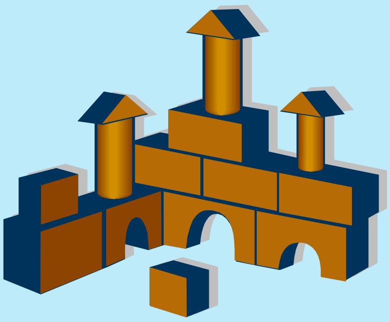
Workload Update

While another five organisations were enrolled since the last newsletter (and brought work with them), we managed to complete more work than came in this month. This included two larger (by our standards) audits, which tied up a lot of time. The backlog therefore became a little smaller, and we are hopeful that by the end of October we will have worked through it all.

Generally, if you have an audit with us, it helps greatly to move things along if our questions are answered within three or four days or so. Any longer than that, and the file usually goes on the backburner again while other files are started on. Since we're always working on the jobs of several different organisations at once, it's easy to lose the momentum if one isn't moving forward, and sometimes quite a bit of time is required to re-familiarise yourself with it.

While our client number seemed to have grown to 87, we weeded out some we haven't heard from in a while (mostly new organisations that never got off the ground), and removed some erroneous double-entries, bringing us back to 'only' 75 at this point in time.

Capital Grants and the Income Statement



Every now and then a community group embarks on a building project, perhaps to create a community centre or other facility for general or member use. This is funded through seeking additional grants and/or other donations. Such capital grants are often a major headache, because of the effect they have on the Income Statement (or 'Statement of Financial Performance') of an organisation.

The grants and donations count as income, but the related expenditure goes directly into the Asset section of the Balance Sheet. Increased income with no expenditure has the effect of greatly increasing the surplus, without making it immediately obvious that this is what is happening. This is obviously very different from the situation for a business, where income doesn't increase just because they want to erect a new building.

Such ‘artificial’ surpluses can have some negative effects. Funders do not always understand the impact of capital projects on the Income Statement of a not-for-profit, and there is no way that they can even discern the increased purpose-driven fundraising effort from the Financial Statements alone, unless some explanation is provided. High surpluses will therefore tempt funders of operational costs to cut their contribution. They may also put off donors or other members, or they may create a negative impression in following years when income and surpluses reduce again to ‘normal’ levels.

Ideally, capital income and expenditure for not-for-profits should both be recognised on the same Financial Statement (the Balance Sheet) to avoid this confusion, but this is not allowed under Generally Accepted Accounting Practice (GAAP).

Meanwhile, community organisations that receive capital grants (and donations clearly earmarked for that purpose) can at least attempt to separate these out on the Income Statement. We would recommend to list operational income and expenditure categories and calculate a surplus/deficit from these first. Then clearly show income earmarked specifically for the capital project, pointing the reader to the relevant capital item in the Balance Sheet, and add it into the surplus/deficit figure.

The Equity section of the Balance Sheet (or your Statement of Changes in Equity if you have one) should also clearly separate out the operating surplus and the capital-designated additional income.

Using your Financial Statements

As a decision-making tool, Financial Statements become stale quite quickly because they give information about the past, which is always rapidly overtaken by the present. But they are usually the best and most reliable picture an organisation has of where they stand, and what the trends were at least over the last two years. Seeing your financial activities laid out over such a reasonably long period of time gives insights that you simply do not get on a day-to-day or month-to-month basis. For an organisation that maintains ongoing operations with employed staff, and that perhaps wants to grow, it is absolutely vital that the Financial Statements are available within a couple of month after the end of the financial year, and analysed by those making decisions about the organisation.

We often get jobs to create Financial Statements in much later than that, sometimes close to a year after the financial year finished. At that point they have become useless – whatever information can be gleaned from them cannot be translated into action anymore as the situation may have changed. At CCA we can see a bit of a trend as organisations that are consistently very late in compiling their Statements tend to be the same ones that get into financial trouble.

A particular danger zone seems to arise for new organisations that are rapidly growing, because they have found a ‘market niche’: at the moment there are a few that provide a response to Earthquakes issues that align well with what the Council (and other funders) want right now. Because money comes easy to those groups, they are complacent about financial and administrative systems. After two or three years, funders then lose patience with accountability requirements that are not being met, and organisations finally scramble to get their administrative side sorted out or risk losing their income – a process that is more often than not painful, causes internal strife, and makes the organisation focus inward and go backwards.

Financial Statements are an output of an organisation’s financial systems, and the timeframe with which they are generated (and submitted for audit, if necessary), is an indicator for how well those systems are working.

Need a part-time Administrator?

We know of a very capable one with several years of experience under her belt who has been made redundant very surprisingly by a community group that decided to downscale its operations. Let us know and we'll put you in touch.