Not For Profit Organisations

Best Practice Financial Management

Show You Care and Be Aware

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- We all want to believe that not for profit (NFP) organisations are full of hard-working people committed to improving Society – and most are.
- Nonetheless, even the most well-meaning NFP's can get into financial hot water
- Unfortunately, the temptation to cover up financial problems can be particularly seductive for NFP managers.

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Mar’17 - Australian losses exceed $K180

According to official documents, financial losses of more than AUD $180,000 in unrecovered funds due to alleged systematic accounting improprieties between Pipe Bands Australia and the Queensland Pipe Band Association have been identified in a financial analysis undertaken by Tim Bodey, the new treasurer of Pipe Bands Australia.

The organization recently discovered financial irregularities allegedly due to a treasurer who held the position for both Pipe Bands Australia and the Queensland Pipe Band Association for three years and nine years, respectively. The matter was reported to the Queensland Police and the Victoria Police, where Pipe Bands Australia is incorporated, and the investigation is ongoing.

Mar’19 – ACPBA loses $K10 in alleged theft

One might assume that recent financial improprieties in other parts of the piping and drumming world would have prompted associations and bands globally to review their protocols and procedures, but the Atlantic Canada Pipe Band Association, the organization that covers the country’s Maritime provinces, has confirmed the alleged accumulated theft of more than $10,000 by its past president.

The total amount allegedly came from a series of small cheques made out by the former president, reportedly forging the second signature, required for an ACPBA financial transaction. The small organization had been without a vice-president, treasurer and secretary, with only the president on its executive team, leaving the books open to a lack of oversight

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Mar'18 – Maxville under fraud scandal

The now former treasurer of the Glengarry Highland Games at Maxville, Ontario, which organizes the North American Pipe Band Championships, has been arrested on charges of defrauding the organization and one other of a total of $600,000 over several years

She is accused of using her professional position as a comptroller to funnel money from her employer to cover shortfalls. An investigation alleges that some of the misappropriated funds were used to cover some of the expenses she incurred through her role as secretary-treasurer

Feb'17 – Christchurch rugby club stalwart admitted $k200 fraud to board member

A Christchurch rugby club stalwart's $K200 fraud was discovered by club volunteers concerned about where junior subs were being spent. Club representatives stumbled upon the fraud when upon questioning the Chairman/Financial Controller and unhappy with his response, they decided to investigate further.

The Chairman admitted the fraud and it seems he paid dozens of club cheques into his own bank account over a two-year period. Some of the money was spent on overseas trips. He was also part of a racehorse syndicate despite having no obvious income. The club stalwart agreed to repay the missing $K200 by sale proceeds of his house.

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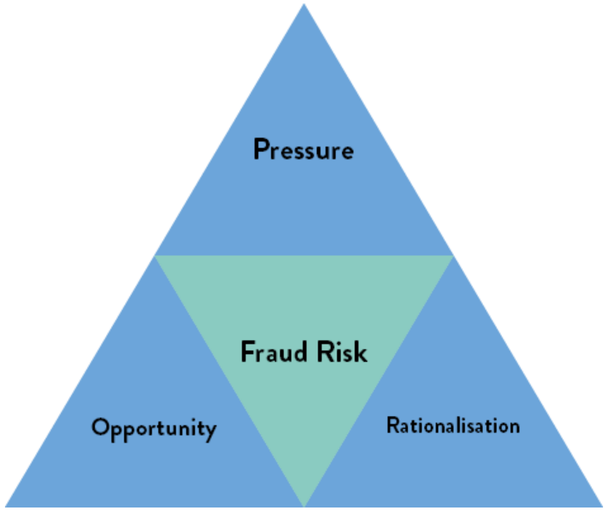
FRAUD

Stories in the press about charity fraud can be a bit alarmist and feel irrelevant to your experience, but even in a small NFP organisation you need to be aware of the risk factors relating to fraud and take steps to protect your organisation.

Whether from inside or outside the organisation, the risk of fraud occurs when there is a combination of three factors:

•**Pressure** – e.g. if someone is struggling financially
•**Opportunity** – if the systems make it easy, if there are no checks and balances
•**Rationalisation** – this often arises if there is a perceived unfairness in the organisation, differentials in pay, or someone feels they have been badly treated, or perhaps if they can justify it as not really doing any harm



What you need

•A good set of financial controls set up to counter the risk of errors
•Controls that are applied to all staff and trustees – seen to be fair
•A leadership that promotes a culture of honesty and integrity

It can be difficult to introduce more formal systems when you are all volunteers and have always just trusted each other. Some people take it personally and resent being checked up on, others don't take it seriously. You might think about asking your independent examiner to make recommendations to the board – people hear things differently from an outsider

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Two prime warning signs that the NFP organisation you care about may be experiencing financial irregularities

1. You can't get Financial Data

- NFP's should be financially transparent
- As a stakeholder you should receive these 5 numbers every month – without having to ask for them

1. Cash balances in all bank accounts
2. Accounts payable ageing report (classic way to get away with fraud)
3. List all credit lines
4. List all confirmed receivables
5. Fixed costs per month

- You should receive 3 financial reports every month

1. Income Statement
2. Balance Sheet
3. Cash Flow

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2. Bullying Behaviour

- It is widely documented that corrupt management tend to engage in bullying.

- A marked characteristic of financial fraud is efforts on part of the management to try to get rid of everyone who is asking questions

- Bullying behaviour includes

  1. Yelling
  2. Intimidation
  3. Rudeness
  &
  4. Refusing to answer legitimate questions

The Financial Management Process

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What’s involved in being a Financial Officer?

Elected Boards, called ‘Boards of Management’, run community organisations. They can also be called ‘Board of Directors’, or ‘Committees of Management’, or a number of other names.

The Board (as we shall refer to it), appoints a Chair (President), a Secretary, and a Financial Officer.

The Financial Officer is usually appointed at the annual meeting and tasked with keeping the finances healthy so the organisation can achieve its mission.

Anyone taking on the role of Financial Officer in a NFP organisation must have – or needs to learn – a basic understanding of accounting and a working knowledge of the laws governing the organisation’s operation.

Being a Financial Officer of a community organisation is a great honour, and a great responsibility.

The position of Financial Officer is the key to keeping the organisation’s finances in order. It requires time, dedication and financial expertise.

Being a Financial Officer of any community organisation will always have its challenges but with the right systems in place to identify and overcome those challenges it will make it far easier to monitor the money coming in and going out from your organisation.

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Duties of the Financial Officer

The principal duty of the Financial Officer is to oversee the financial administration of the organisation.

Keep up to date records as well as an audit trail for all transactions. The organisation could consider appointing an external auditor for overview and support of the financial management function.

Protect the organisation against fraud and theft, ensuring safe custody of money, prompt banking, and segregation of duties relating to the financial management of the organisation.

Present meaningful reports to the Board to support effective decision making and ensure the Board understands them

Make sure the Board understands its financial obligations (i.e. who to report to and when and consider setting up a compliance calendar)

Make sure the organisation complies with tax regulations, such as GST, payroll tax and fringe benefits tax

Review all internal processes and reporting methods at least annually

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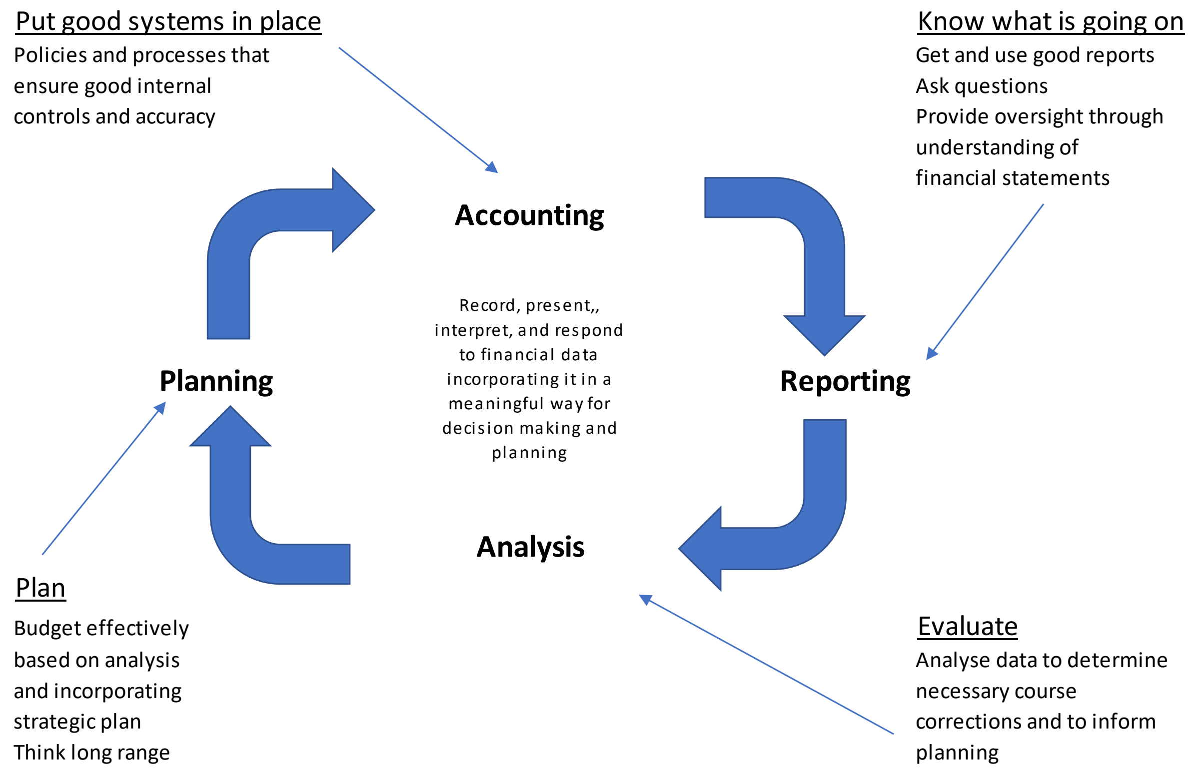
Financial Management

Whether your organisation is large or small, effective financial management is an ongoing process featuring a cycle of good management habits. Sound procedures and internal controls help ensure accurate accounting and high quality reporting. Evaluation of the information in the reports then informs planning and facilitates good management decisions. Regular evaluation of the process leads to consistent improvement in financial management.



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POLICIES AND PROCEDURES

All NFP's, large and small need sound systems for regulating and recording financial transactions. There should be an audit trail for every financial transaction.

Best practice financial management will be achieved with written policies and guideline. This is sometimes called a Financial Procedures Manual.

Your systems must be appropriate for your organisation, and your manual should describe all your organisation's financial administrative tasks and specify who is responsible for each one.

Documenting your financial procedures is also a good opportunity to check your processes and see if you have adequate controls. As you work through your processes, imagine you are doing the task for the first time and ask yourself questions like

- How do we record transactions?
- How do we classify transactions?
- Who collects the information?
- Who records the information into our bookkeeping system?
- How do we check the information is correct?
- What financial reports do we produce from this information?

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POLICIES AND PROCEDURES (CONT'D)

Responsibilities
Your manual will include responsibilities of key members in your organisation e.g. the Board's financial responsibilities may be to:

- Develop a strategic plan
- Approve the budget
- Determine control procedures
- Determine control procedures
- Apply for grants
- Handle bad debts

Areas of financial management
As well as looking at your financial management in terms of responsibilities, you will need to look at your systems for each financial activity

<u>1. Budgeting</u>
Document procedures for
- Budget development
- Obtaining board approval
- Reporting of variances

<u>2. Income</u>
Document your procedures for
- Issuing invoices
- Recording donations, fundraising, bequests etc
- Following up invoices
- Receiving and banking money

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POLICIES AND PROCEDURES (CONT'D)

3. Expenditure

Document your procedures for

- Purchase orders and invoice payments
- Bank signatories
- Credit cards
- Petty cash
- Asset purchases

4. Reconciling

Record procedures for

- Reconciling the cash book with your bank statements (bank reconciliation)
- Keeping the asset register up to date
- Managing investments

5. Investments

Document procedures for

- Recording the due dates of long term investments
- Gathering information on re-investment
- Approval of re-investment/other use of funds

6. Reporting

Document procedures for

- Interim reporting to the Board
- Annual reporting to the Board
- Reporting and making payments to the IRD
- Reporting requirements for grants and sponsorships

7. People

Document your people policies and procedures for

- Systems for paying salaries and superannuation
- Contracts of employment
- Reimbursing out of pocket expenses
- Volunteer time and value

8. Assets

Develop a system for

- Recording acquisition of assets in the asset register
- Working out depreciation
- Regularly reviewing asset values
- Periodically stock taking your assets
- Recording disposal of assets

Keeping the books

Cash v Accrual Accounting

In **accrual accounting** revenue is recognised when it is earned rather than when it is received, and expenses are recognised when they are incurred, rather than when they are paid.

With **cash accounting** you record entries according to the date you paid someone or when someone paid you

Cash accounting is the simplest form of bookkeeping and small organisations may find it adequate. If your organisation operates largely on short-term transactions and you don't have long-term debts or commitments, cash accounting will work as long as your organisation stays small. If you start growing, you will need to switch to accrual accounting.

Accrual accounting is used by many organisations because it gives a better idea of your organisation's overall medium-term financial status and performance.

Method	Income is recorded when….	Expenses are recorded when….	Measures
Accrual	Earned	Incurred	Profit
Cash	Received	Paid	Cash

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The main accounts

Balance Sheet

The balance sheet shows the financial position of an organisation at a particular point in time (often the end of the financial year)

Assets – what you own
Assets is the collective term for all the things that your organisation owns. There are two types of assets – current assets and non-current or fixed assets
Current assets are assets you use in your everyday operations or assets you intend to dispose of within the next 12 months. They include

- Money in the bank or on hand, also known as cash
- Money owed to you within 12 months, known as debtors or accounts receivable
- Items you intend to sell or give away within 12 months, known as stock or inventory
- Other short term investments

Fixed or non-current assets are used by the organisation over a longer period of time. These include things such as furniture & fittings, vehicles, land & buildings. The wear & tear on these assets in daily use means their value declines. Your accounts need to show this as depreciation. Fixed assets can be further classified in tangible assets and intangible assets
Liabilities – what you owe
Liabilities are the money that your organisation owes to others. Again there are two types – current and non-current
Current liabilities are those which must be repaid within 12 months and include

- Bank overdraft or credit card
- Suppliers also known as trade creditors or accounts payable
- Employee entitlements
- Short term loans and some lease payments

Non-current or long-term liabilities are sources of finance supplied to your organisation, which are not due for repayment in the next 12 months
Equity – your net worth
Equity is your organisation's net worth. It is essentially how much your assets are worth less the money you owe (liabilities). It includes the original start up capital and any accumulated surpluses

Balance sheet (as at 30 Jun xxxx)

Assets	
Current Assets	
Cash	5,000
Accounts receivable	1,000
Inventory	5,000
Non-current assets	
Property, Plant and equipment	100,000
Total assets	111,000
Liabilities	
Current Liabilities	
Accounts payable	14,000
Wages payable	2,000
Provision for employee entitlements	3,000
Non-current liabilities	
Long-term debt	25,000
Total liabilities	44,000
Equity	**67,000**
Total Liabilities and Equity	111,000

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Income Statement

Income

Income includes all the money your organisation receives. It includes (but is not limited to) membership fees, grants, donations, sales of products and services, special events, consulting fees and sponsorships. Each type of income should be recorded separately so you can have an understanding of where it comes from

Expenditure

Expenditure is all the money your organisation pays out to operate. The two most common types of expenditure are operating and capital expenditure.

Operating expenditure is money you use to run the organisation, It includes overheads, salaries, supplier bills, and maintenance, to name just a few.

Capital expenditure is money you spend on assets that will last longer than one year, such as computers, furniture & equipment, cars, land & buildings.

Operating and capital expenditure are treated differently as the cost of the capital expenditure is spread over the expected life of the asset. The item is recorded as an asset and a depreciation charge is made against income each year.

The total income received by the organisation less its expenses is recorded in the Income Statement (also known as a Profit and Loss statement or Statement of Financial Performance). If there is more income than expenses the organisation has made a surplus (or profit) and the funds are retained to accumulate in the organisation as Equity. This supports long-term sustainability and growth. If there are more expenses than income then the organisation needs to either borrow money or reduce assets to cover the shortfall.

Income Statement

	This Year Jul-Jun $	Last Year Jul-Jun $
Sales	500,000	425,000
Cost of sales		
Opening stock	75,000	57,000
Purchases	235,000	215,000
	310,000	272,000
Closing stock	-65,000	-75,000
Cost of sales	245,000	197,000
Gross Profit	255,000	228,000
GP Margin	51.0%	53.6%
Expenses		
Wages & salaries	101,230	95,000
Rent & rates	20,140	20,140
Heat & light	2,350	2,420
Communications	4,400	3,980
Insurance	1,200	1,100
Depreciation	4,100	3,500
Legal & professional fees	2,500	2,300
Accounting & audit fees	5,000	4,500
Travel expenses	12,000	11,800
Advertising & PR	24,350	24,220
Repairs	3,720	2,790
Printing & stationery	6,240	5,950
Sundry expenses	940	800
Bank interest & charges	1,110	1,200
Total overhead expenses	189,280	179,700
	37.9%	42.3%
Net profit	65,720	48,300
	13.1%	11.4%

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Tracking the cash

Organisations will receive income and make payments vis a number of different methods. Keeping track of what's coming in and what's going out is vital to having accurate records to build financial statements and meet audit

Cash Handling
Here are some tips for good cash handling

- Count and bank cash promptly (many ATMs take deposits after hours)
- Issue receipts and use your copy to balance the cash on hand
- Sometimes receipts are not appropriate in which case you should count the money at the end of each event and record how much you have collected and what it is for.
- Never pay wages or expenses from cash waiting to be deposited
- If you are keeping a petty cash box the ensure it is balanced regularly

Bank reconciliations
A bank reconciliation is a schedule that explains the differences between the bank statement balance and the organisation's cash balance.

Prepare your bank reconciliations by matching all deposits and withdrawals with your records of income and expenditure. Your bank statement may not equal your cash records because of timing differences, unpresented cheques, and other information not in your cash records, such as interest paid or received. The reconciliation is a record of why they are different.

By reconciling regularly (monthly is highly recommended) differences can be rectified early and not become a potential problem in the future

Bank Reconciliation
Bank account: Operating account 03-xxxx 123456-xxx
Date of statement: 31/10/20xx

Outstanding withdrawals		
Date	**Detail**	**Amount**
27/10/20xx	Chq10102	1,500.00
28/10/20xx	Chq10103	56.10
29/10/20xx	Chq10104	565.50
30/10/20xx	Chq10105	249.95
TOTAL		**$2,371.55**

Outstanding deposits		
Date	**Detail**	**Amount**
31/10/xx	Inv177658	1,540.00
31/10/xx	Inv177659	2,130.00
31/10/xx	Inv177660	965.00
TOTAL		**$4,635.00**

Reconciliation	
Closing cash book balance	$65,473.20
Add: Outstanding withdrawals/unpresented cheques	$2,371.55
Subtotal	**$67,844.75**
Less: Outstanding deposits	$4,635.00
Bank account balance	**$63,209.75**

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Accounting Systems

A computer system is not a substitute for paper records. Make sure you keep a hard copy audit trail of all your financial transactions, including receipts, cheque book stubs and tax invoices. You will need these for annual audit purposes if prescribed and/or random tax audits depending on your organisation's status.

There is no one method of bookkeeping.

Small organisations may use a paper-based system, but larger organisations will need to use a software package to ensure they are processing transactions as efficiently as possible and with the lowest potential for error.

Spreadsheet programs are an intermediate step between paper-based and software systems. Spreadsheets may not have the security and control of software packages, but they are cheaper to run.

Also ensure you make regular back-ups of your computer records. Hard drives do crash, and data does get lost. Keep your back-ups in another location, so they are safe in the event of a fire or burglary.

Very small organisations can get by with what's called 'shoebox' accounting with all accounts kept in a box or filing cabinet. Try to organise your material into folders, large envelopes or separate compartments of a folder for separate items such as: correspondence, Bank statements, outstanding bills, paid bills and receipts, asset file with instructions and guarantees, lease file for equipment and rental hire, Insurance, cash book – record of your cash receipts and payments, statutory information – constitution, budget and minutes.

One step up from shoe box accounts is a ledger or a journal of income and expenditure. You can use books for ledgers, develop your own spreadsheet or use commercial software. Information in ledgers will include: Date, Receipt number (if appropriate), who was paid, who paid the money, purpose, account, amount.

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Cash-flow is crucial

All NFP organisations need to manage their cash-flow so they have enough money to pay the bills. These bills include day-to-day running expenses and large sums predicted and planned for in your annual budget.

In cash-flow management, timing is critical. You must have money available to pay the bills when they come in. If you run out of cash you can't pay your bills on time and unless arrangements are made to cover shortfalls, you may end up in financial difficulty.

It is the responsibility of every board member (and especially the Financial Officer) to ensure that systems are in place that will prevent the organisation from trading while insolvent. Any breach of this requirement can create financial risks for individual board members.

For many community based organisations, income isn't known at the beginning of the year as it is based on the generosity of donors etc. Especially in these circumstances, a good cashflow regularly reviewed will assist in making your decisions regarding the level of activity of the organisation.

A cashflow has the following crucial characteristics

- It is a numerical picture of your predicted flow of funds for a particular period, usually month-by-month for the year ahead.
- It allows you to predict what cash you think will come in and how much will go out over that period.
- It is an extension of your budget and you should do it at the same time as you prepare your budget for the year ahead.
- Factor into your cashflow all payments such as wages, asset purchases, loan payments etc.

Creating a cashflow forecast is not difficult once you've got the figures, but getting accurate figures is the challenge. The easier way to do this is to start with previous budgets, cashflow statements or cashflow forecasts to see if there are clear patterns of income and expenditure – then consult your current strategy and budget to see if any major income or expenditure is expected and when this is likely to occur.

Your cashflow forecast must also include estimated bank balances for easy comparison with your actual bank balances. The closing balance for each period is the opening balance for the next period.

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Legal Structures

The NFP sector is extremely diverse. Some organisations are incorporated, some have their own acts of parliament, some are mutual societies, and others are branches of church-based organisations, just to name a few. The legal structure of the organisation will determine its tax obligations, reporting requirements, and legal obligations.

The most common legal structures for NFP organisations are:

- Unincorporated associations
- Incorporated associations
- Company limited by guarantee
- Co-operatives
- Charitable Trusts

Unincorporated associations

The simplest structure available and generally used by small, informal community groups. This type of organisation does not have a separate legal identity and cannot hold assets or offer legal protections for members. This means that people acting for the organisation are personally liable for their actions. They are simple to establish and may or may not have a formal constitution which generally means there are very few administrative requirements.

Incorporated associations

The most common structure adopted by a significant number of NFP organisations. Incorporated associations are registered under the Incorporated Societies Act 1908 and in doing so becomes a separate legal entity. This type of organisation can lease, rent, buy and sell property, borrow money and enter contracts in its own name. No member of the society can have personal rights or interests in any asset of the society. Members will not be personally liable for the debts, contracts or other obligations of the society unless:

- The debts or obligations are incurred for pecuniary gain or incurred through unlawful activity.

The Incorporated Societies Act 1908 sets out the level of administration and financial reporting required by the organisation allowing the members assurance that there will certainty to the way the society is run.

Company limited by guarantee

A company limited by guarantee is a special type of public company whose members specify the amount they are willing to contribute to the organisation if it is wound up, which limits their liability in that instance. It comes with very strict requirements around company conduct, financial reporting, and communications with members. While it allows organisations to operate nationally the strict requirements may be too onerous for smaller less resourced groups.

Co-operatives

A lee common structure often used by groups who form because they have a common need or purpose. Co-operatives are democratically owned and managed and unlike other legal structures for NFP organisations they may carry out for profit ventures and distribute profits to members.

Charitable Trust

A legal structure used when the purpose of the organisation is to distribute funds held in trust to other not-for-profit organisations. Each of these are established and administered in accordance with a specific trust deed

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Tax facts

NFP organisations may have to pay income tax, GST, FBT and payroll tax.. This will have implications for the way you keep your accounts and your transaction records.

Tax concessions

Many community organisations are exempt from paying income tax, but this is not an automatic right.

To qualify for tax exemption your activities must not be carried out for the profit or gain of individual members.
Your NFP organisation can still make a profit, but these profits must be used to carry out your organisation's purposes, not distributed for personal gain to members
Although NFP's can't operate for the financial gain of individual members, they can pay their members for their services or compensate them for expenses the incur on behalf of the organisation

Concessions available to many NFP organisations are:
- Income tax exemption
- GST concessions (re making of taxable supplies requirement)
- FBT exemption or rebate

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Charities Services Registration

There are obligations that come with being a registered charity, and one of these is to comply with the new reporting standards that came into effect in April 2015. All registered charities must now comply with these standards regardless of their size, activities or income.

Common reasons organisations become registered charities with Charities Services

- **Income tax exemption** is one of the main reasons.
- **Donee status** Donors may claim tax credits on all donations over $5. This mean when people make donations to your charity they can claim 33% tax back on their donation
- **Funders** some funders may only provide funding grants to registered charities
- **Status as a registered charity** improved public perception from being a charity regulated by government and visible on the public Charities Register

Charities new reporting standards are part of a tiered system. All charities default into Tier 1, but may choose to report in another tier if they meet certain criteria. The criteria for each tier is shown below. The tier that a charity reports under is determined by the annual expenses or operating payment of its previous two financial years

Tier 1	Tier 2	Tier 3	Tier 4
Full Standards	Reduced Disclosure Regime	Simple Format Report-ACCRUAL	Simple Format Report-CASH
Over $30 million annual expenses	Under $30 million annual expenses	Under $2 million annual expenses	Under $125,000 annual operating expenses
or has public accountability	without public accountability	without public accountability	without public accountability

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The importance of auditing

An audit is an independent check of an organisation's financial records by a suitably qualified professional. The purpose of an audit is to confirm that the organisation's finances are being accurately reported as there are many stakeholders who rely on this information.

The audit requirements for NFP's depend on their legal structure and any registrations (such as being a registered charity).

Incorporated societies that are not registered as charities under the Charities Act 2005 will be required to have a mandatory audit when they satisfy one of the following criteria:
- Annual expenditure of over $2 million; or
- Assets over $4 million

Incorporated societies that are registered charities are required to have a mandatory audit when annual expenditure is over $1 million and either an audit or a review when annual expenditure is over $500,000. However you may be required by your rules (trust deed, constitution, or charter) or as a condition of receiving a grant to have your financial statements audited or reviewed. It's important to know what the requirements are for your entity and whether or not you are required to have an audit or review.

Even if your organisation is not legally required to be audited, it is a good idea to have an audit or review to provide some reassurance that your accounts are complete and accurate.

The auditor will perform tests on your accounting systems, review your internal accounting controls, examine corroborating documents, analyse your procedures, and check your cash accounts and other balances.

Once the auditor has reviewed your accounting principles and financial statements, you will receive a report which will give the auditor's opinion on whether the financial statements have been prepared correctly.

The auditor may also discover weaknesses in your internal financial systems and provide a separate report to the Board recommending changes to your processes and procedures.