The Fiscal Health of Not-For-Profits: Survey Results and Management Assistance Needs

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Introduction

In 1993 Revenue Canada reported more than 70,000 registered charities in Canada. A report by the Canadian Centre for Philanthropy estimates that over $86 billion passed through registered charities in 1993: approximately 12 to 13 per cent of Canada's Gross Domestic Product. Charities paid $40 billion in salaries and benefits to 1.32 million people; nine per cent of the Canadian labour force.

Charitable organizations are funded from a number of different sources including government grants and contracts (which overall provide 56 per cent of the money), charitable donations from individuals and corporations, foundation grants, bequests, the proceeds of community fund-raising events, and others.

The size and economic significance of the not-for-profit sector, of which registered charities are just a part, is such that the financial management of the societies, social and health agencies, educational institutions, arts and cultural organizations, and others of which it is comprised, are of interest to everyone.

Recently several well recognized charities have been challenged publicly on issues of alleged lack of financial control, poor financial policies, and unclear financial reporting. Financial management and the communication of financial information are continuing concerns, as not-for-profits are not always able to retain the financial and personnel resources needed, nor to develop the institutional infrastructure necessary, to handle the "numbers" effectively and efficiently.

These fiscal issues, as well as others, were identified in a 1992 meeting called by United Way of the [British Columbia] Lower Mainland and attended by management, research staff and executive directors from several member agencies and financial and management consultants in the charitable sector.

Out of the concerns expressed and discussed at that meeting, and on the basis of information gathered on other occasions, the project discussed in this article was proposed. Funding for the study came from the Kahanoff Foundation with phased contributions by United Way of the Lower Mainland over three years.

The study was divided into two distinct phases. Phase one, the research phase, was designed to identify the issues of financial management and internal and external financial reporting from the perspectives of people closely connected with the financial operations of charitable organizations. These included agency executive directors and directors of finance, agency treasurers and board members, the auditors of charitable organizations, and representatives of charity funding sources (government, foundations, and United Way).

The research also collected information on accounting practices and auditing procedures by analysis of existing financial statements, through interviews, and by direct study of a small number of organizations. Information on practices and critiques of financial reporting in the charitable sector were also searched out using secondary sources of information. A financial consultant[1] to the charity sector assisted in the analysis and interpretation of financial data.

The second phase of the project, the service development phase, was designed to evolve out of the research to provide a service to the charitable sector which could both help ensure the adherence to common accounting standards and provide continuing assistance with financial management issues and reporting for broad purposes of accountability.

Methodology

The research phase data were gathered by three principal devices:

1. A mail survey of United Way members and affiliated agencies. The survey collected agency identification data, financial reporting, budgeting and auditing information as well as respondents' views on financial issues of concern to them. An analysis of respondents' financial statements was also undertaken by the financial consultant to the project to further identify difficulties and issues in reporting practices.

   A total of 112 agencies were originally invited to take part. The intention was to select a subsample of the respondents to the mail survey for more in-depth exploration of financial issues in focus groups. Of the 76 agencies which agreed to take part in the project, 66 agencies (86 per cent) returned completed questionnaires. In addition, 59 of the 66 returned copies of their current annual financial statements for review and analysis.

2. Four two-hour focus group sessions were held with 28 of the responding agencies in a mix of large and small organizations: an average of seven agencies in each group. The focus groups were designed to explore, in more depth and unstructured ways, issues which had been identified in the survey as being of concern to either respondents or the research investigators. Focus group participants included staff and volunteers from the organizations in the study.

3. A few interviews were held with key informants drawn from focus group participants and additional respondents representing the advisory committee to the project, not-for-profit funding bodies, and financial analysts with field experience of not-for-profits.

Activities of the project were steered by an advisory committee whose primary functions were to review critically the methodology and progress of the study at key points and to provide guidance for future work. The 13-member committee was drawn from government and voluntary sector funding bodies, service providers, the field of not-for-profit accountancy and academics.

The Findings

Insofar as could be determined from the questionnaire completed by the 66 agencies, there is good accountability and fiscal health in the financial management of the not-for-profits surveyed. There were some expected differences between large and small agencies but, in general, the size and the age of the agency did not seem to affect its fiscal health.

On such variables as the involvement of volunteers and the use of professional advice, the financial management and budgeting procedures used, and reporting activities undertaken, there were no simple divisions into healthy versus unhealthy agencies. However, within this general conclusion from the survey, there were a number of financial issues which were followed up in more depth in the focus groups and interviews.

The results of the survey, focus group discussions and interviews are combined and presented under topic headings related to three broad research questions: How is the not-for-profit administered financially? How is budgeting done and reported? What is the nature and role of the financial reporting system?

Financial Administration

The research first explored who was responsible for financial management. In the 64 agencies reporting, professional accounting qualifications were held by 25 per cent of the senior staff responsible for financial affairs. Senior volunteers (most often the board position of treasurer) had professional accounting qualifications in 59 per cent of the cases.

Among the staff with accounting qualifications, two were CAs, nine were CGAs, and five were CMAs. Another 15 staff respondents listed other bookkeeping and accounting qualifications. In 33 cases the senior staff responsible for financial affairs reported no accounting qualifications.

In the 60 agencies reporting, volunteers with board or committee responsibility for the financial affairs of the agencies, 27 volunteers were CAs, seven were CGAs, four were CMAs, two had other financial qualifications, and 19 did not have accounting qualifications.

There were 14 agencies where neither the staff nor the volunteers responsible for the finances had professional accounting qualifications. In eight of these cases the agencies had staff complements of less than 20 and total operating budgets of less than $500,000. However, in all but one of the 59 organizations which submitted annual financial statements for review, professional accounting help was used.

There was a general acceptance from respondents that financial matters were becoming increasingly complex and that assistance was becoming increasingly necessary. In addition, rapid growth by not-for-profits as they strive to meet increased demands for service also results in the need to seek professional assistance, particularly in the areas of computerization and service auditing.

There does not appear to be a clear relationship between the qualifications of key staff or financial volunteers and certain financial practices such as the existence of a stabilization fund; the existence of an annual deficit or surplus; or long-term debt or surplus. In fact, agencies whose senior staff had no accounting qualifications were more likely by far to have annual operating surpluses. Surpluses were slightly more likely to be achieved if the senior volunteer was a CA.

In total, 53 agencies showed a long-term surplus, two a long-term debt, and 10 agencies showed break-even situations in their financial statements. In both cases of debt, the amount was less than 10 per cent of revenue. Surpluses ranged from less than 10 per cent of revenue to over 50 per cent. There were 22 agencies with deficits and 33 agencies with surpluses. Of those agencies with an annual deficit, 18 had a long-term surplus. Of the 33 agencies with annual surpluses, none had long-term debt.

In 63 per cent of cases agency staff had been responsible for setting up the books, most often together with the treasurer, a board member, or an outside consultant. The person responsible for setting up the books had a professional accounting qualification in 66 per cent of agencies overall, but in a lower proportion (55 per cent) of small agencies (those with fewer than 20 staff members).

There was evidence that few agencies had systematically created policies and procedures covering any more than basic/routine aspects of financial management. Focus group discussions and interviews revealed, however, that the creation of standard policies and procedures which could be adapted to meet the particular requirements of the not-for-profit would be beneficial.

Volunteer Involvement

The degree to which volunteers were involved in the financial administration varied considerably over the sample. Most agencies (68 per cent) had a finance committee of the board. Those which did not, tended to be the smaller agencies;

17 agencies (26 per cent) reported having an audit committee. The average size of the finance committee was five to six people, with most agencies having two- to four-member committees, comprised mainly of volunteers. In 73 per cent of cases the executive director was the staff member, in the other cases the committee was staffed by the finance director (or equivalent). On average there were between one and two staff members, usually only one. There was one agency with no staff member on the finance committee.

In eight organizations there was a budget committee of the board with an average volunteer contingent of three members and one member of the staff (the executive director).

In 60 of the 65 agencies reporting (92 per cent), financial management reports (mostly prepared on a monthly basis) were shared with the board or finance committee. Typically, the reports were also provided to senior staff. However, in nine agencies the board was the recipient of the information. In just over half of all cases, the reports were presented to the board for approval rather than for information only.

Responsibilities of the Board

Not all board members accepted responsibility for financial matters. In some cases, board members were content to rely on those with professional accounting credentials. (The tendency to rely, in a trusting way, on professional expertise was also the case where the "expert" was a staff person within the organization.)

The group discussions revealed that confusion often exists among board members as to their legal obligations and accountability. When there is no clear understanding of responsibility it was suggested that it may be necessary to procure board liability insurance to absolve board members "carrying out their duties in a prudent manner" from liability. In the future, failure to address this issue will affect the willingness of qualified and prominent individuals to serve on boards. Unfortunately, such liability insurance does not seem to be readily available at an affordable price.

Basic Knowledge of Finances

Respondents generally agreed that while it was not necessary for all board members to be thoroughly conversant with the details of financial affairs, it was nevertheless important for all to have a basic understanding of key indicators of fiscal health in order to fulfil accountability responsibilities. Focus group discussions and interviews revealed that this desired level of knowledge had not been attained to the respondents' satisfaction.

In addition to a general understanding of the agency, it is still necessary that a smaller number of board members possess sufficient detailed understanding so that they do not become solely reliant upon either internal accounting staff or external professional assistance.

Small agencies and large agencies differ in their reliance on board members. In the smaller agencies financial knowledge was not generally available internally or externally and therefore dependence centred on those board members with this expertise. In larger agencies, non-financially-oriented board members may be content to allow the fiscal monitoring to be undertaken by others with this expertise.

In assessing the fiscal health of the agency, board members need to be thoroughly apprised of the environment in which the agency operates. This would include not only knowledge of the agency's development but the larger situational factors such as government policy, demographic trends, community needs and service-delivery trends in the public, private and not-for-profit sectors.

Board members drawn from the world of business, corporate funders and professional advisors need to understand the not-for-profit status of the organization with which they are connected. Particularly, social agency staff respondents felt that such volunteers did not always appreciate that agency success can be considered in terms of service output rather than the often intangible and difficult-to-assess service outcome; that organizational emphases are expressed in terms of meeting community need rather than being primarily based on cost- effectiveness. In other words, running a counselling program is not the same as running a business where the bottom line is expressed in monetary terms.

Finally, it was noted in the discussions that an understanding of "the numbers" is not considered enough if the ability to communicate financial information to others within and outside the not-for-profit is deficient. These "process" skills are needed in the not-for-profits, in addition to the traditional "technical" skills. In too many cases the average board member was seen as reticent about requesting lay interpretations of the jargon of the expert.

The Budgeting System

Agencies reported that most often the framework of principles used to guide budgeting was developed by staff with some input from volunteers. The most frequent pattern reported was for the planning to be undertaken by the executive director (sometimes with other senior staff) and the finance committee of the board or with the board. Most agencies (40, or 64 per cent) said their budget was part of an overall long-term or strategic plan. This was more likely to be the case for large agencies. Over a third (23, or 36 per cent) however, said their budget was not part of a long-term plan. This response did not seem to be related to agency age or field of service.

Budgets were typically prepared by senior staff and senior volunteers. In 53 agencies (82 per cent) the executive director was the staff person; in the other cases the finance director or accountant was cited as the person responsible. The volunteer responsible for budgeting was usually the treasurer (68 per cent) but in other cases was the president, vice-president, or finance committee chair.

Most agencies (27 of 65) reported using an incremental line-by-line approach to their budgeting (four of these agencies also said they used last year's budget plus or minus a percentage change). The incremental method was used by agencies irrespective of age, size or professional input.

The next largest group (24 of 65 agencies) said they normally used a budgeting method based on the previous year's amounts plus or minus a percentage change. This percentage was based on a wide variety of variables. The most often cited were: the inflation rate, government contracting negotiations or expectations, changes in services or new programs to meet community needs, fund raising expectations and gaming revenues, staffing levels, salary increases, and board direction.

A "zero based" approach to budgeting was reported by 18 agencies. It is not possible to discern from the questionnaire whether all respondents to this category defined zero based in the same way. It is possible that the previous year's expenditures were considered by some as a "zero" starting point for development of the current year budget. It is interesting to note, however, that "zero based" was more often the approach reported where a CA or CGA was the senior volunteer or where a CGA was the senior staff person responsible for financial affairs. The previous year's budget plus or minus a certain amount was more likely to be the chosen method where the senior staff or volunteers had no accounting qualifications at all.

Most agencies (57) prepared budgets annually; four agencies prepared them semi-annually. All but five agencies used single-year projections. Those using multiple-year projections used two-year (two agencies), or three- and four-year projections (one each).

Budget approval usually involved the board (58 agencies). In other cases respondents indicated approval by a team of staff and volunteers. Once the budget was approved, 61 agencies said they used a system of budget review. Most reviews took place monthly (34 agencies), quarterly reviews were reported by 12 agencies, and the remainder responded "as required" or gave other time frames.

Budget review was typically undertaken by senior staff (mostly the executive director) and the senior financial volunteers. In five cases it appears that volunteers were not involved in the review process.

Budgets supplied a number of different levels of detail. In 31 cases "to date experience" was reported. Other agencies indicated "overall review", and "line-by-line". In only 11 agencies was projection to year-end specifically reported. Some of these agencies (18 per cent) were, one suspects, surprised by their year-end position.

In 54 of the 60 agencies which undertake a budget review, the result of the review is communicated to the board. In two thirds of the cases the results are shared with agency staff and funding bodies received review results from 12 agencies.

Although the respondents indicated that there was nearly universal use of budgeting as a tool of financial management, few were created within a framework of predetermined board-approved guidelines, parameters or "fiscal values". Minimally, such guidelines should include who budgets (staff and volunteer roles), frequency of budgeting, the process of review, reporting procedures, budget format and detail level.

The respondents indicated that several methods were used in preparing a budget. These included line-by-line review, across-the-chart or category increases by a particular factor, or "zero-based" budgeting.

Focus group discussions confirmed our suspicion that the frequent questionnaire response "zero-based" may have been the expected response and certainly indicated a lack of understanding of what would be involved in true zero-based approaches (which could be disruptive of agency operations).

Budget Participants and Review

Respondents indicated wide divergence in the degree of involvement of program staff, financial management, and the board in the budgeting process, but agreed that to achieve successful compliance with the provisions of the final budget, it is necessary to involve actively those who will be responsible for implementing the budget as well as those involved in its creation. This was not reported as the most typical scenario. In many cases the direct responsibility for the expenditure and revenue components of the budget did not reside in the same person or group within the agency.

Again, a wide range of approval processes was found. The importance of acceptance or "buy-in" or "sign-off" obtained from those who must implement the budget before it is formally approved by the board, and thus established, was not always appreciated.

One area where, clearly, assistance to not-for-profits is required is in the purpose and process of budget review. Regarding operational modification after budget approval resulting from periodic reviews, questions were raised by respondents as to whether the purpose was simply to compare actuals to budget, rewrite the budget, or make adjustments to comply with the budget.

Researchers pointed out in the discussions that, although circumstances during the budget period will change, it is not necessary or appropriate continually to adjust the budget. The projection figure will reflect the changes and variance analysis and explanations will adequately explain the changes. The important question for agencies to ask themselves is, "What processes are in place to correct organizational operations which may be leading the agency into financial difficulty?"

Another area of concern was a lack of specific cash-flow budgeting by respondents. Focus group discussions and interviews overwhelmingly agreed that it was necessary to integrate cash flow management into the budget process. This step ensures that the budget and actual information will permit management decisions to be made that ensure that adequate cash is available or is made available and that excess cash resources are utilized as a method of in-house fund raising.

Long-Term Planning and Stabilization

Only five respondents to the survey admitted to multiple-year budgeting, although there was strong interest in long-term (strategic) planning. The general interest in strategic planning requires that the financial planning aspects of this area should be given priority in financial management training. One concern commonly expressed is that long-term financial goals may drive an organization in inflexible ways.

In the focus group discussions, long-term fiscal health was often related to being able adequately to take care of unforeseen circumstances. Support for the establishment of stabilization (contingency or rainy day) funds was popular. However, although a number of existing rules of thumb were mentioned, no consensus was obtained from focus group discussions regarding the appropriate size of a stabilization fund. It was generally agreed that the appropriate size must be based upon a review of the particular not-for-profit's vulnerability to fluctuations in revenues and an estimate of unexpected emergency expenditure requirements. Thus, the size of the fund or balance would be unique to each not-for-profit and should be reviewed periodically to ensure appropriate levels.

Discussions also revealed the need for guidance on the mechanics of fund establishment and, in particular, how best to obtain acceptance by volunteer boards which may see the exercise as creating a "slush" fund rather than as a contingency planning vehicle.

Information and Reporting

The quality, format and use of financial information were explored in depth in this study through the survey, review of agencies' actual financial statements, and in the focus group discussions and interviews.

Two types of information were identified quite consistently by respondents, that which satisfied an internal need to enable board and staff to monitor and manage the organization, and that which performed an external function to communicate financial data to outside interested parties and to comply with audit obligations. These were often seen as quite different whereas in an ideal world one information system would provide the data for both and the two reports together would contribute to good organizational management.

Respondents and focus group participants indicated that, although the basic numbers required for internal reporting and external financial statements are derived from the same accounting system, significant differences exist with respect to focus and degree of detail or aggregation. We found that, by and large, external reporting instruments fulfilled a narrow compliance function and were not generally seen as contributing to day-to-day financial accountability.

There was general agreement from focus group participants that the need to communicate meaningful and understandable financial information to users possessing varied levels of expertise and knowledge, especially given the increasing complexity of not-for-profit organizations, presented a somewhat daunting challenge.

Internal Information

The general purpose of internal financial reports is to gather and communicate the necessary information to enable the board to provide guidance and for the staff and management to manage.

The study indicates that there are two basic activity or income statement formats used to communicate the financial information of not-for-profits: i) functional and ii) program or fund.

Generally the program or fund format is used for internal reporting. This format segregates and summarizes the revenues and expenditures related to a specific program or task. A summary of revenues and expenditures by function is generally provided to communicate the activity of the entire entity. In the past, a functional format predominated in external financial statements, however the current trend is toward a program or fund format.

The focus group discussions indicated some reluctance to provide in-depth details of the not-for-profit, as would be the case with program or fund accounting. The reason for this hesitation was not clear.

The matter of an external reporting format will probably be resolved by the new Canadian Institute of Chartered Accountants (CICA) rules for nonprofits.

Standardized Accounting Policies

Following 20 years of discussion, the new *Handbook* embodying these rules was issued in March 1996. Its regulations apply to fiscal years beginning on or after April 1, 1997. [For further information see also 13 *Philanthrop.* No. 3, p. 38.]

Those with calendar year-ends will not be affected until their March 31, 1998 financial statements. Despite the time lag it is advised that adequate consideration be given now to creating and implementing the necessary policies and procedures to identify and capture the additional information required to meet the new *Handbook* provisions in an efficient, cost-effective and timely manner.

There was some resistance expressed by the focus groups to the new principles set out in the *Handbook.* The main contentious issues related to how fund raising costs are presented and the recognition of assets. With respect to fund raising costs, the CICA Guidelines now require that material revenue and expenditure figures (i.e., those which may materially affect the financial report) can no longer be "netted" to reduce the magnitude of the revenues and expenditures.

In addition, there is a requirement by CICA that all assets must be recognized on the balance sheet, or in footnotes to the financial statement, again if they are material to an understanding of the financial situation of the organization. It has been customary that assets be expended in the year purchased or gifted; however, this practice prevents the direct comparison of financial statements of similar not-for-profit organizations.

Use of Computers

Both respondents in general and focus groups indicated a lack of knowledge and comfort with computers, although the need was never disputed.

All but six of the smallest agencies use an in-house computer for at least part of their accounting. General ledger was the most frequently reported computerized function (56 agencies) with about two thirds of those with computers (40 agencies) also having payroll and accounts payable on computer. Generally, the program of choice was AccPac (68 per cent), with others most often reported being Bedford and Lotus.[2] Fifteen agencies reported using an external data bureau, most of them for payroll. Of these 15 agencies only two did not have an in-house computer system.

The fiscal year of agencies in the sample was most often reported as April to March (38 agencies) followed by the calendar year (24 agencies). Year ends of June or July were reported by three agencies. Most stated that the choice of fiscal year was independently made by the agency (60 per cent); 14 agencies (22 per cent) said it had been determined by a requirement of the funding bodies.

With regard to information which would allow service cost calculations, there were 14 agencies which did not record staff hours, 44 which did not record volunteer hours, 13 which did not record the number of clients served, and 27 which did not record the number of client visits. Where these statistics were recorded, staff hours were most usually recorded in total for the agency, and clients served or client visits were broken down by program or service.

Surprisingly, 13 agencies (20 per cent) did not record any service-delivery information (clients served or client visits made). These agencies were of all sizes and ages (eight of them had been in operation for more than 30 years), and in all fields of service.

External Reporting

All not-for-profit organizations that are societies [the B.C. name for non-share-capital corporations] have minimal reporting requirements for the Registrar of Companies.

A review of the financial statements and questionnaires indicated that most had their financial statements audited. Unfortunately, this is not an indication of the total number of not-for-profits that have a professional accountant conduct an audit as this is a specific requirement for members in the United Way of the Lower Mainland, from which the sample was drawn.

The focus group participants indicated that there were concerns that not all internal and external users of the financial statements understood them.

Focus group discussions indicated that some not-for-profits did not take "ownership" of their external financial statements because of a lack of internal knowledge and technical expertise.

Some respondents suggested that minimal disclosure to the public was desirable. On the other hand, some felt that not-for-profits owed a responsibility to the public to report on activities because they are either directly funded by the public or receive tax-preferred treatment on donations received.

Annual Financial Statements

Of the 59 agencies submitting financial statements, all but one used outside professional help with the preparation of their annual reports. In most cases the professional was a CA (75 per cent) or CGA (22 per cent). This was fully paid consultation at market rates in 22 instances, partially donated in 34 cases and fully donated to three agencies.

On the specific issue of Revenue Canada's Charity Information Return (the T3010) 18 agencies said they received professional help with its completion, 35 said they did not, and 11 did not know if help was given.

The level of reporting that professionals were required to use was audit in 55 cases, compilation in 16 cases, and review in 14 cases. Respondents checked more than one level. Most agencies (44) indicated that the audit level of reporting was required by their bylaws and about half of the agencies also stated that funding bodies stipulated this level.

Sixty of 62 agencies answering the question stated that an audit is prepared every year, one agency said every four years, and one "as needed".

There was generally a high level of satisfaction with the service professional accountants provided to not-for-profits. Most agencies (49 of 58 reporting) felt that the external professional accountant understood the not-for-profit nature of their organizations. Nine agencies felt this was not the case but were not very specific about their criticism except to say that the accounting firms were unfamiliar with charities and obviously most often dealt with for-profit organizations.

Focus group discussions and interviews, however, revealed a greater concern than reported in the survey. Agency staff, particularly, felt that the professional accountant did not always appreciate the "organizational culture" or "the emphasis on service delivery" as being different from the for-profits for which they most often worked. This lack of understanding would no doubt reduce the benefit of the expertise available.

While there was a general tendency for the larger agencies to engage the "Big Six" or "major" accounting firms to perform their audit and prepare the financial statements, these were just as likely as any other accounting organization to need assistance in understanding the not-for-profit sector. Particularly, respondents felt that the accountants did not fully appreciate the implications for agency survival of the precarious nature of their funding base—the unpredictable charity dollar, the challenges of a rapidly changing community both in size and ethnic diversity, the cutbacks in government-provided service, and the changes in government funding with a stricter emphasis on contracts, leaving less discretionary revenue to service providers.

Satisfaction with the performance of the professional help received varied slightly, with most agencies being either Very Satisfied (29) or Satisfied (22). Two agencies were Dissatisfied, one Very Dissatisfied and five agencies were neither satisfied nor dissatisfied.

Two thirds of the agencies indicated that different financial reporting formats were required by different funders. On average 4.8 different formats were prepared; two agencies said they prepared more than 10. The highest number occurred among agencies in the "services to families", and "multicultural service" categories. The need to standardize requirements, especially among government funders, was cited by 20 agencies as the most pressing issue.

Federal, provincial, and municipal governments, United Way and foundation grants were identified as five major funding sources. Sixteen agencies received funding from all five sources, 19 agencies from four sources, 13 from three sources, 10 agencies from two sources, and seven agencies from one. In addition, 40 agencies listed other funding sources, mainly gaming and community fund-raising activities.

Thirty-seven agencies (58 per cent) received federal government funding from up to seven different departments (average 1.7 departments); 49 agencies (74 per cent) received provincial government funding from up to six different ministries (average 2.5 ministries).

The majority of agencies present annual statements to their boards for approval; in three cases agencies presented them for information only. General distribution of the complete annual statements was reported by 45 agencies (70 per cent); in 17 cases only a summary in the annual report is distributed. Fifty-five of 61 agencies reporting said their financial statements with the auditor's report were available to the public on request.

Annual Financial Statement Content

In general, the financial statements reviewed seemed to fill a narrow compliance function rather than meeting multi-purpose internal and external needs. The lack of consistency in the presentation of information is perhaps not surprising given the current absence of any reporting standards. The overall impression of the 59 financial statements submitted to accompany the questionnaires was that in 52 cases the presentation was "adequate".

Most agencies (38 of 59) used an April to March fiscal year, 18 agencies budgeted on a calendar year. The presentation of information, despite the fact that some respondents used the same firm of accountants, showed very little consistency. In fact, the 59 agencies exhibited 59 different ways of reporting their finances.

Revenue and expenditure details were judged inadequate in 35 of the 59 statements. Most concern centred on the lack of detail, inconsistent terminology, and the poor or nonexistent reporting of fund-raising revenues and associated costs.

Surpluses / Deficits and Accumulations

Follow-up discussions in the focus groups indicated that few not-for-profits had policies covering the reporting of annual surpluses and deficits and accumulated surpluses and debts as well as stabilization funds.

A number of agencies incurred annual surpluses and deficits. In six cases annual deficits were over five per cent of operating budgets, and in 13 instances agencies carried surpluses in excess of five per cent of budget. The data also showed a number of accumulated surpluses, but only two agencies with accumulated debts.

Respondents realized that a failure to discuss or justify a surplus/deficit or accumulation might cause concern to a financial statement reader. This "concern" could adversely affect donations, funding decisions, and organizational reputation.

Most not-for-profits participating in this project are social service agencies which are funded on the basis of specific program grants. It was, therefore, not unexpected that few would show significant accumulated debts. Focus group participants agreed that significant debts, such as those experienced by some arts organizations, are not "bad" in themselves but that an explanation and the existence of a specific plan of debt reduction would be required to indicate fiscal responsibility and fiscal health.

Detailed review of the statements identified a number of areas where further review is required or where presentation improvements are recommended. These include: the use of professional assistance; the intended use of the statements and their usefulness to different audiences; the nature and content of the auditor's report; "scope limitation" and "going-concern" qualifications,[3] standardization of terminology especially regarding revenue and expenditures; the presentation of fund raising information—use of terms and costs; the existence of stabilization funds and annual debts or surpluses; balance sheet data, especially accumulated results (surpluses and debts); and statements of changes in financial position.

Indicators of Fiscal Health

There was general acceptance from all respondents that it was necessary to supplement traditional financial statements to the board with summary information and explanations of variance from budget. Research revealed a lack of key indicators of financial performance (fiscal health) although there was overwhelming acceptance that the existence of such indicators, tailored to specific not-for-profits, would greatly assist the exercise of sound fiscal monitoring responsibilities by staff, management and board members alike.

A comprehensive list of "fact patterns" that are usually present when agencies are in, or about to experience, serious financial difficulties, does not exist. Respondents endorsed the concept of determining a list of warning signals which would suggest corrective action to prevent more serious problems and so avoid the need for crisis management.

Summary and Outcome

In brief, the research produced a large number of issues of concern with advice often sought by participants in the course of the study. This was especially the case in the focus groups where the interactive format showed a wide disparity in the knowledge and understanding of financial reporting and principles of financial management and encouraged respondents to admit frankly the need for assistance. Issues of concern ranged from complex accounting procedures to the mundane and sometimes raised "naive" questions such as what percentage of budget should be assigned to "administration".

Perceptions of volunteers and staff as focus group participants were sometimes similar, at other times they showed a very different perspective on the operations of not-for-profit organizations. There was very little appreciation of the need for all volunteers and staff to possess good understanding of the financial affairs of the agencies, and particularly among small organizations, there seemed to be a ready acceptance of reliance on the "professional expert". Most participants admitted that fewer than half their board members could read, understand, and were capable of questioning financial statements presented to them.

It also became clear that organizations and their boards use a very wide variety of procedures for financial data gathering, reporting formats, budgeting procedures, and processes for disseminating information internally and externally. There were also many different opinions among agencies of similar size and budget about what were considered as key indicators of fiscal health, and differences in perceptions of what was of high priority importance in fiscal monitoring activities.

While most societies seem to be fully aware of their financial positions, some gave rise to concerns about how well they really understand the details of them. Still others (a small minority) leave the impression that they may have perhaps muddled through and survived more by accident than design. It is these exceptions which suggest the need for two levels of assistance: a consultation service which can respond on call to individual agencies experiencing financial management problems, and a more general educational service which can assist in imparting to all nonprofits the "how to" of establishing general principles of sound financial management.

The field of enquiry in this research has confirmed, rather than uncovered, a plethora of financial management styles and procedures; a lack of uniformity and consistency in the reporting of financial affairs; a lack of clarity in financial reporting formats; the use of terminology without definition; unnecessary complexity in reporting; and uncritical (blind trust) acceptance of expert financial analyses. These gaps and concerns are highlighted in pursuit of the ultimate goal of this study which is to equip not-for-profit organizations with the knowledge necessary for sound fiscal health, not to create a Procrustean financial management system into which all must fit.

Consultation and Assistance

The many results from the research, ranging from the very general to the detailed and specific, gave rise to immediate action. Workshop-style training seminars were held for local not-for-profit organizations experiencing a need for the same kind of advice or problem-solving activity. The seminars were held through a unique collaboration between United Way and the VanCity Credit Union. Sessions provided the opportunity for VanCity better to understand the nature of not-for-profit societies and for the societies to share the experience of a major financial institution in banking and business planning.

The design of the training seminars included a one-day session for selected VanCity staff which concentrated on imparting an understanding of the not-for-profit environment, highlighted issues of financial management peculiar to service-providing organizations (particularly where mixed public, private, and voluntary-sector funding is the norm), the role of the volunteer board member, typical fiscal issues, and ways in which organizations can learn through participative, experiential, action-orientated methods.

The VanCity staff then worked with United Way to become co-leaders of the seminar and to assist in the design of the course and development of a brochure. A booklet entitled "The Internal Control Self-Audit for Not-for-Profit Organizations" was produced as a take-away for participants. Sessions covered such topics as "the warning signals of fiscal ill-health", "key questions a board member should ask", and "the essential indicators of financial operation executive directors should provide to their boards and staff".

Representatives from 85 social- and health-service organizations attended the sessions.

Evaluations revealed a high level of satisfaction and a desire for more workshops in the future. Financial management consultation for agencies remains a priority of United Way and a continuing benefit of membership.

FOOTNOTES

1. Christopher J. K. Richardson, F.C.A., Director, Gift Planning, Vancouver Foundation, was retained under contract for the duration of the research phase as financial consultant to the project. The author wishes to acknowledge his invaluable experience and the assistance provided in analyzing the data and presenting the results.
2. AccPac is distributed by Computer Associates, Vancouver, BC, which now also handles the Bedford accounting package under the name of AccPac – Simply Accounting. Since this research several other suitable accounting packages have been marketed and in addition to the Lotus 123 spreadsheet program, Microsoft Excel spreadsheet is also used by respondents.
3. A "scope limitation" statement defines the extent of the audit, indicating areas where financial control may not be as complete as elsewhere in the report; "going concern" qualifications refer to the auditor's confidence in declaring the organization to be viable.

United Way of the Lower Mainland
Principles of Financial Management

- Financial information needs to be communicated throughout the organization in a format that is "user friendly". Everyone should strive toward the equalization of knowledge.
- Volunteers and staff have the responsibility for understanding financial information. Ultimate financial accountability rests with all members of the board of directors.
- Through a participative group process, volunteers and staff need to analyze financial information and develop agreement on what it means to each in terms of strengths and weaknesses.
- Budget development should be a participative process involving volunteers and staff throughout the organization. This helps to ensure ownership, understanding and effective monitoring.
- There should be regular budget reports throughout the year to enable the organization to assess budget performance to date and projection to year end.
- Budgets should be developed on a fiscally conservative basis.
- Current year financial information should be reviewed in the context of five-year financial information. This allows for the identification of trends. There should be agreement across the organization regarding the meaning of the five-year data in terms of strengths and weaknesses for the organization.
- All financial information should be fully disclosed to volunteers, staff and key stakeholders.
- There are two major "bottom lines" within not-for-profit organizations: the quality and effectiveness of the services, and the fiscal performance. Volunteers and staff have a shared responsibility for both.