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Finance Fundamentals

Maria Bélanger CA

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Who We Are – Capacity Builders

- **The Charity Law Information Program (CLIP) provides training, workshops, webinars to charitable organizations to enhance their understanding of their obligations under the *Income Tax Act* as well as improve governance and ethics**
- Capacity Builders is a division of the Ontario Community Support Association (OCSA) and it runs CLIP
- <http://www.capacitybuilders.ca/clip>
- CLIP Communiqué
- 416-256-3010 x 232 or 1-877-484-3030
- clip@capacitybuilders.ca



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Charities Directorate Of CRA

- Regulates registered charities
- Based in Ottawa and other offices throughout Canada
- Website: www.cra.gc.ca/charities
- E-mail list: www.cra-arc.gc.ca/esrvc-srvce/mlst/sbscrbchrts-eng.html
- Webinars: www.cra-arc.gc.ca/tx/chrts/cmmnctn/sssns/wbns-eng.html
- Telephone: 1-800-267-2384 (English)
1-888-892-5667 (Bilingual)
- Provided funding for the Capacity Builders' Charity Law Information Project (CLIP)



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All About You!

- Please complete an index card:
 - Name
 - Organization you're involved with
 - Position
 - Comfort level with financial matters (1 to 10)
 - Your email address





Agenda

- **Budgeting**
 - Responsibility
 - Types of budgets
 - Budgeting techniques
 - Expense worksheet
 - Income worksheet
 - Monitoring the budget
 - Capital Budget
 - Cash Budget
- **Internal Controls**
 - Elements of internal controls
 - Cash controls
- **Books and Records**
 - Keeping adequate books and records
 - Cash basis vs. accrual
 - Annual financial statements



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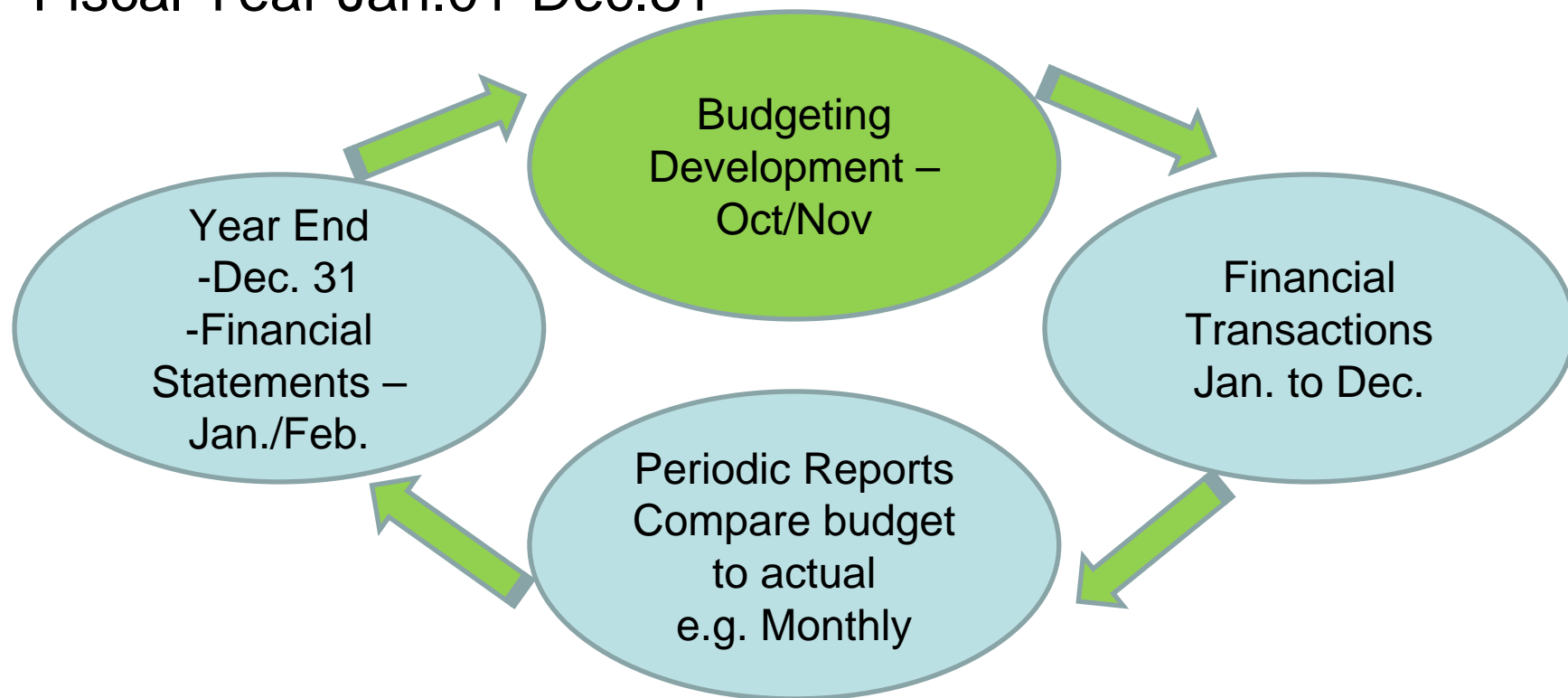


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Financial Reporting Cycle

ABC Charity

Fiscal Year Jan.01-Dec.31





Budgeting

- What it is:
 - Document that translates plans into money
 - Estimate (informed guess)
- What it is **NOT**:
 - Written in stone: can be changed
 - A copy of last year's + 10%
 - Admin work
 - Optimistic and unrealistic picture



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Who needs budgets

- Board of directors
- Executive director
- Project managers
- Fundraisers
- Finance staff
- Donors
- Community partners



Budgeting

Responsibility

- Board members are responsible for the overall management of the organization's resources.
 - Required to **approve** the budget
 - Does the budget reflect the organization's priorities?
 - What are the fundamental assumptions upon which the budget has been prepared (eg. Inflation rates)?
 - Who is responsible for monitoring and controlling budget expenditures?



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Budgeting

- Responsibility (continued):
 - Board is responsible to carefully review all reports relating to financial affairs, including interim and year end financial statements.
 - With the assistance of senior staff, carefully review and participate in formulating the annual budget and strategic plan.



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Before you develop the budget

- Goals
- Strategic Planning
 - The budget
- Who should be involved?
 - Finance manager/bookkeeper
 - Director
 - Staff
- Timeline



Different Kinds of Budgets

- Income and expenditure budget (also called “operating” budget)
 - Shows anticipated costs and revenues
 - Usually prepared for short periods such as monthly or quarterly.
- Capital budget
 - Prepared for large fixed asset expenditures in coming years.
- Cashflow forecast
 - Used to monitor availability of cash



Budgeting Rules

- Plan further ahead:
 - Budget for coming year will be more accurate
 - Following years will give indication of levels of funding needed.
- Contributions in kind should be included as a note.
- Keep your notes to check where amounts come from.
- Break the budget for coming year into a **monthly** budget.
 - Helps for cash flow and assessing variances.



Steps to Preparing a Budget

1. List items on which you spend money.
2. Estimate the unit cost of the line items, then annual costs.
3. List likely sources of income
4. Prepare budget format
5. Add in notes to explain items
6. Get feedback
7. Finalize the budget.



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Getting Started

Income
sources

Expenses

Notes



Budgeting Techniques

- Incremental Budgeting
 - Amounts are based on actual expenditures from previous year with a % added for inflationary increase.
 - Often inaccurate.
 - Suitable if each year is very similar to previous years.
- Zero-Based Budget
 - Past figures are not the starting point.
 - Process starts from “scratch”
 - Takes more time to do



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Budgeting Techniques

- **Survival Budget** – minimum required for the organization or project to survive
- **Guaranteed Budget** – based on income guaranteed at the time the budget is planned.
- **Optimal Budget** – covers what you would like to do if additional money becomes available
 - Becomes part of working budget if money is available.



Expense Worksheet

Expenses	Amount last year	Increment %	Amount Budgeted	Note
Rent	\$12,000	3%	\$12,360	1
Salaries / benefits	\$25,500	3.5%	\$26,393	2
Supplies	\$1,500		\$900	3
Program costs	\$14,000	2.0%	\$14,280	4
New project costs	\$0		\$0	5
Total	\$53,000		\$53,933	
Notes:	<ol style="list-style-type: none">1. Used rate announced by landlord2. Use rate agreed in employment contract3. Estimated; we'll go paperless.4. Used cost-of-living increase5. Tied in to evaluation of uncertain income; if income comes through expenses will be \$19,500.			



Projecting Various Kinds of Income

- Estimate percentage of certainty of receiving
 - Costs related to this uncertain income should be “flagged” and controlled
- Use a conservative approach
- Look at:
 - Prior years’ experience
 - Pledge collection rates
 - Net income from other activities
- Document:
 - Status of negotiations
 - Percentage of certainty or likelihood of receipt



Income Worksheet

Source	Estimated Amount A	Likelihood of Receipt B	Amount to Include in Budget A X B
Membership Dues	\$ 10,000	80%	\$ 8,000
Grants	\$ 50,000	100%	\$ 50,000
Uncertain Income	\$ 20,000	10%	\$ 0
Total Amount of income to include in budget			\$ <u>58,000</u>

Notes: Uncertain income is not included because the likelihood is too low and this is a project we've never done before.



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Budgeting Issues

- Contingency amounts?
 - Not recommended
 - Budget should be realistic



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Budget Format

- Can have budgets by program
- Show three years of budgeted information
- Show total income
- Customize format for donors if required.
- Include explanatory notes.



Budget

	Jan.	Feb.	...	Dec.	Total
<u>Income</u>					
Memberships dues	\$667	\$667		\$667	\$8,000
Grants	<u>4,167</u>	<u>4,167</u>		<u>4,167</u>	<u>50,000</u>
Total	\$4,834	\$4,834		\$4,834	\$58,000
<u>Expenses</u>					
Rent	1,030	1,030		1,030	12,300
Salaries/Benefits	2,199	2,199		2,199	26,393
Supplies	50	50		150	900
Program costs	<u>1,000</u>	<u>1,200</u>		<u>200</u>	<u>14,280</u>
Total	<u>4,279</u>	<u>4,479</u>		<u>3,579</u>	<u>53,933</u>
Excess of revenues over expenses	<u>555</u>	<u>355</u>		<u>1,255</u>	<u>4,067</u>



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Monitoring the Budget

- Monitor income and expenses to see if “on target”, at least on a **monthly** basis.
- Report status to staff, board and donors.
 - Provide report at least a week before meeting.
- Make financial decisions.
- Compare regularly.



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Monitoring the Budget

- Prepare a variance report.
- Report on:
 - Monthly income & expenses compared to monthly budget amount.
 - Year-to-date actual comparison with year-to-date budget amounts.
 - Compare to last year.
 - Add percentage variances.
 - Add explanations.



Monitoring the Budget – Questions

- Is the income/expenditure in line with the budget ($\pm 10\%$)
- Are there any significant variances? Have they been satisfactorily explained?
- What action is being taken to correct significant variances?
- Are there any large invoices outstanding that could substantially affect amounts shown?
- Is the organization owed large sums of money? What is being done to retrieve them?
- Are there any un-budgeted expenses which may occur in the rest of the year?
- What is the projected end-year outcome? Is this satisfactory?



How to Read the Budget Report

1. Look at the bottom line: is it what you would expect?
 - What is the variance from the budget (usually $\pm 10\%$ is acceptable).
2. Look at the budget variance column:
 - Identify significant variances ($\pm 10\%$) or significant expenditures.
 - What reason is given for variances? Are they reasonable?
 - Are variances temporary or permanent?
 - How can funds be found to pay for permanent negative variances?
3. Look at the % of the budget that has been used.
 - Is it at the level you would expect?
 - Are there any items showing zero expenditure?



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How to Read the Budget Report

4. Look for linked budget items
 - Are they behaving consistently?
5. Look for unusual or unexpected amounts of expenditure or income.
6. Look at the narrative report
 - Does it tell the same story as the budget report?
7. Look for solutions
 - Can under-spends be used to fund over-spends?



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Budget Report for the Quarter

	Total Budget	Jan-Mar. Actual	Jan-Mar. Budget	Variance \$	F/ U	Variance %
<u>Income</u>						
Memberships dues	\$8,000	\$2,100	\$2,000	\$100	F	5%
Grants	<u>50,000</u>	<u>11,750</u>	<u>12,500</u>	<u>(750)</u>	<u>U</u>	<u>(6%)</u>
Total	\$58,000	13,850	14,500	(650)	U	(4%)
<u>Expenses</u>						
Rent	\$12,360	\$3,090	\$3,090	0		0%
Salaries/Benefits	26,393	6,598	6,598	0		0%
Supplies	900	435	225	210	U	93%
Program costs	<u>14,280</u>	<u>3,122</u>	<u>3,570</u>	<u>(448)</u>	<u>F</u>	<u>(13%)</u>
Total	<u>53,933</u>	<u>13,245</u>	<u>13,483</u>	<u>(238)</u>	<u>F</u>	<u>(2%)</u>
Excess of Rev. over Expenses	\$4,067	\$605	\$1,017	\$(412)	U	(40%)



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Capital Budget

- Ties in to long-term strategic goals
- Used to budget items that will have an economic impact for longer periods
- Assess viability and return on investment
 - Cost overruns
- Financing:
 - Loan covenants



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Capital Budget

- Funds may be separate from funds for operating purposes
- May need to:
 - Accumulate capital reserves
 - Arrange a mortgage
 - Launch a specific fund development campaign



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Cash Budget

- Maps out cash inflows and outflows on a monthly basis.
- Helps to identify cash shortfalls and plan accordingly:
 - Adjust spending
 - Set up bank overdraft protection
- And cash surpluses
 - Surplus cash can be invested.



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Cash Budget

- Examine each line item of operating budget to determine cash inflow/outflow impact.
 - Depreciation (non-cash expense)
 - Loan repayments (not an operating budget expense).
 - Purchase of fixed assets.



Cash Budget

	Jan.	Feb.	Dec.	Total
<u>Incoming Cash</u>					
Memberships dues	\$6,000	\$2,000		\$0	\$8,000
Grants	<u>0</u>	<u>10,000</u>		<u>0</u>	<u>50,000</u>
Total	\$6,000	\$12,000		\$0	\$58,000
<u>Outgoing Cash</u>					
Rent	\$3,090	\$3,090		\$3,090	\$12,360
Salaries/Benefits	6,598	6,598		6,598	26,393
Supplies	50	60		350	900
<i>Program costs</i>	<i>1,090</i>	<i>1,090</i>		<i>1,090</i>	<i>13,080</i>
<i>Equipment purchase</i>		<i>5,000</i>			<i>5,000</i>
Net receipts (disb.)	(\$4,828)	1,172		(\$10,828)	\$267
Beg. Cash Balance	\$4,000	172		12,600	4,000
Sale of inv. - borrowing	1,000				4,600
Purch. Of inv.					<u>(6,828)</u>
Ending Cash Balance	<u>\$172</u>	<u>\$1,344</u>		<u>\$1,772</u>	<u>\$1,772</u>



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Monitoring the Cash Budget-Questions

1. Is there enough cash in the bank to fulfill the plans in the next six months?
2. What amounts are due in the rest of the year and are they still expected to come through on time?
3. Are excess cash balances invested to produce the best return?



Internal Controls

- “Internal control is the process designed and effected by those charged with governance, management, and other personnel to provide reasonable assurance about the ***achievement of the entity's objectives*** with regard to reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.”
 - GAS section 5141.042



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Elements of Internal Controls

Control Environment

- Communication and enforcement of integrity and ethical values.
- Commitment to competence.
- Participation by those charged with governance.
- Management's philosophy and operating style.
- Assignment of authority and responsibility (see next slide).



Elements of Internal Controls (Cont.)

Assignment of authority and responsibility

- Need a “Delegated Authority Document” approved by Board of Directors, annually, to clarify who has authority to make decisions, commit expenditures and sign documents on behalf of organization.
- Instructions for duties such as:
 - Signing cheques
 - Placing and authorizing orders for goods and services
 - Handling incoming cash and cheques
 - Access to the safe and petty cash
 - Checking and authorizing accounting records
 - Signing legal documents.



Elements of Internal Controls (Cont.)

Separation of Duties

- Separate “incompatible” functions, usually record-keeping and access to assets.
- Where separation is not possible (for example because of small staff), then oversight is required.
- See case study.



Elements of Internal Controls (Cont'd)

Procurement procedures

- Process for ordering, receiving and paying for goods and services;
- When is it necessary to obtain quotations

Signing cheques

- Ensure sufficient people to keep payments efficient.
- NEVER sign blank cheques.



Elements of Internal Controls (Cont'd)

Reconciliations

- Verify accounting records on a monthly basis to make sure there are no errors or omissions
 - Bank reconciliation
 - Petty Cash

Physical Controls

- Having a safe
- Insurance



Elements of Internal Controls (Cont.)

- Safeguarding assets
 - Assets register
 - Building and equipment maintenance policy
 - Vehicle policy
 - Depreciation
 - Insurance
 - Maintenance and repair
 - Private use by staff
 - Carrying of passengers.



Cash Controls

- It's the most liquid and volatile asset.
- Need policy to describe how to receive and handle cash.
- Keep money coming in **separate** from money going out – all payments by cheque.
- Always give receipts for money received.
 - See CRA's Checklist for issuing complete and accurate donation receipts
 - <http://www.cra-arc.gc.ca/tx/chrts/chcklsts/rcpts-eng.html>



Cash Controls

- Always obtain receipts for money paid out.
- Deposit surplus cash into the bank.
- Restrict access to petty cash and the safe.

Tip: Put a sign on desk reminding donors that they should receive receipts for all donations.



Dealing with Fraud and Irregularities

- Impact is damaging due to loss of reputation.
 - Affects donor confidence
 - Morale of employees and volunteers
 - Possible loss of funding
- First line of defense is “deterrence”
- Don’t look the other way: report the incident to a superior or board member.



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Keeping Adequate Books and Records

- See CRA's Checklist
 - Handout;
 - <http://www.cra-arc.gc.ca/tx/chrts/chcklsts/bks-eng.html>
- Members of the board of directors have a duty to ensure that the organization keeps proper books of accounts.



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Keeping Adequate Books and Records

A charity's books and records must allow the Canada Revenue Agency (CRA) to:

- verify revenues, including all charitable donations received;
- verify that resources are spent on charitable programs; and
- verify that the charity's purposes and activities continue to be charitable.



Keeping Adequate Books and Records

Books and records include:

- Governing documents (incorporating documents, constitution, trust document), bylaws, board and staff meeting minutes, annual reports;
- financial statements, copies of official donation receipts, copies of annual information returns (Form T3010, Registered Charity Information Return),
- written agreements, contracts;
- ledgers, bank statements, expense accounts, inventories, investment agreements, accountant's working papers, payroll records, promotional materials, and fundraising materials.



Keeping Adequate Books and Records

- Books and records also include **source documents**. (invoices, vouchers, formal contracts, work orders, delivery slips, purchase orders, and bank deposit slips).
- The charity should also keep copies of its books and records in a separate location (preferably off-site) for backup purposes.

What are the consequences of improper record keeping?

- Failure to keep adequate books and records may result in the suspension of a registered charity's tax receipting privileges, or the loss of its registered status.



Keeping Adequate Books and Records

How long must a charity hold on to its books and records?

- **Minutes of meetings of the directors/trustees/executives** - for as long as the charity is registered.
- **Minutes of meetings of the members** - Must be kept for as long as the charity is registered.
- **Governing documents and bylaws relating to the charity** - for as long as the charity is registered.
- **General ledgers or other books of final entry** - for six years from the end of the last tax year to which they relate.
- **Financial statements, source documents and copies of annual information returns (T3010 forms)** - for six years from the end of the last tax year to which they relate.



Cash Basis vs. Accrual Basis

- **Cash Basis:**
 - Income and expenses are recorded when received or paid.
- **Accrual Basis:**
 - Income and expenses are recorded when they “occur”.
 - This means that cash received in advance may be “deferred”, recorded on statement of financial position rather than statement of operations.
 - Expenses incurred but not yet paid need to be recorded.



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Cash Basis vs. Accrual Basis

- If incorporated in Ontario, then required to use “accrual” accounting under Business Corporations Act.
 - This requirement also exists under the federal Canada Corporations Act.
- If you are unsure which to use, consult your accountant



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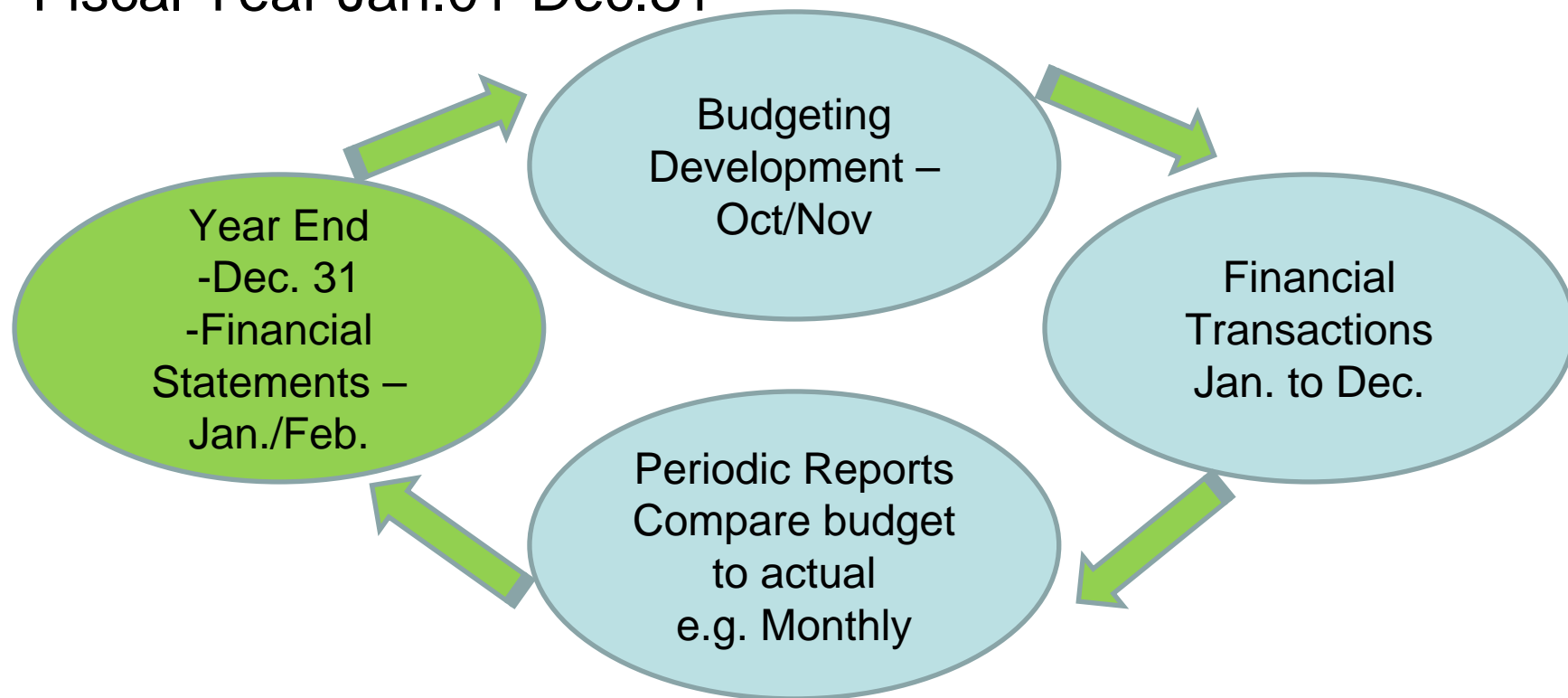


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ABC Charity

Fiscal Year Jan.01-Dec.31





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Annual Financial Statements

- Statement of Financial Position (Balance Sheet)
 - Statement of Operations (Income Statement)
 - Statement of Changes in Net Assets
 - Statement of Cash Flows
- + Notes



Annual Financial Statements*

- The financial statements can be presented either:
 - With information in a single column;
 - On a “fund” basis with a column for each fund.
 - This involves a “self-balancing” set of accounts for each fund.



Annual Financial Statements*

Statement of Financial Position (Balance Sheet)

- Purpose: To present resources (assets), obligations (liabilities) and net assets.
- Provides information to assess with the organization will continue to be able to provide services, achieve its objectives and meet its obligations.



Annual Financial Statements*

Statement of Operations (Income Statement)

- Purpose: Information about changes in resources and obligations.
- Provides information about cost of service delivery and extent to which they are funded by contributions and other revenue.
- Expenses may be classified
 - by object (salaries, rent, utilities);
 - by function (administrative, research, etc.) or
 - by program.



Allocating Expenses*

- Some expenses benefit more than one function or program, either directly or indirectly.
- Costs incurred for several programs (**direct costs**) must be allocated using a “reasonable” basis (ex: photocopying, staff person working on two programs, ...).
 - Charge directly as many costs as possible.
 - Apply basis consistently



Allocating Expenses*

- Other indirect costs such as overhead, general and administrative expenses can be allocated on a rational and justifiable basis.
- Bases for allocating:
 - Time
 - Usage
 - Per capita
 - Space
- Things to watch out for:
 - Program or funder limitations on allocated expenses



Allocating Expenses*

- Goal of allocating
 - To approximate the true cost of running a program or activity;
 - To maximize the cost reimbursement from the funding source



Annual Financial Statements*

Statement of Changes in Net Assets (Changes in Fund Balances, if using fund accounting)

- Purpose: Provides information about net resources available for services delivery in the future.

Statement of Cash Flows

- Shows cash inflows and outflows classified into 3 areas:
 - Operations (ongoing service delivery activities)
 - Investing
 - Financing



Types of Contributions

1. Restricted Contribution

- Subject to *externally* imposed conditions that specify purpose for which it is to be used. (ex: for the purchase of a capital asset).

2. Endowment Contribution

- An *externally* restricted contribution specifying that the resources be maintained *permanently*.

3. Unrestricted Contribution



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Interpreting the Accounts

- Trend analysis:
 - Examine same ratios over several years to determine if trends exist (eg. Proportion of donor funds to total revenues)



Interpreting the Accounts

Ratio analysis

Statement of Financial Position (Balance sheet):

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

- This ratio examines how much liquid assets are available to pay off current liabilities.
- General rule of thumb: 2.0

$$\text{Quick (Acid-Test) Ratio} = \frac{[\text{Current assets} - (\text{Prepaid expenses} + \text{Inventory})]}{\text{Current liabilities}}$$

- This ratio examines the ability to cover current liabilities out of current assets that are readily convertible to cash.
- General rule of thumb: 0.8 to 1.2



Interpreting the Accounts

Ratio analysis

Statement of operations (Income Statement):

- Compare expenses as a % of income

$\text{Expenditure item} / \text{Total income} \times 100$

- Compare relative proportions of sources of income

$\text{Donor income} / \text{Total income} \times 100$

– Analyzes donor dependency



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When to Computerize

- Factors to consider:
 - Is the software compatible with auditors' or financial advisors'? Does it need to be?
 - What training is required to operate? Are staff already trained?
 - What hardware is required?
- How to keep documentation and approval



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Other Resources

- www.capacitybuilders.ca/clip
- www.cra-arc.gc.ca/tx/chrts/prtnng/menu-eng.html
- www.civicus.org
- www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00688.html
- www.johncammack.net
- www.mango.org.uk



To audit or not to audit?*

- Do you know what an audit entails?
- Do you know if your organization needs one?
- Is a clean audit report a “clean bill of health”?
- Do you know if you will be able to obtain a clean audit report?



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Evaluation

- Your feedback is important to the Charity Law Information Program
- Please complete the Evaluation Form and add any comments that will help improve our program
- If you have any additional feedback, contact clip@capacitybuilders.ca
- Thank you for your participation today!