

Reading Financial Statements



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As board members it is imperative that you at least develop a basic understanding of how to read your financial statements because these statements provide a clear picture of the financial condition of the organization. There are four main financial statements required by Generally Accepted Accounting Principles (GAAP) which include the following reports: Statement of Financial Position, Statement of Net Assets, Statement of Operation, Statement of Cash Flow, and Notes to Financial Statements.

The Statement of Financial Position report shows the organization's assets (what the organization owns), liabilities (debt/obligations that the organization has not yet paid), and net assets (difference between the total assets and total liabilities) at a fixed point in time. In the asset section you will find current assets which include cash accounts, certificates of deposits and investments, and items such as receivables which will be converted to cash within one year. Capital assets include items such as buildings, furniture, and equipment. In the liability section you will find current liabilities which include accounts payable to vendors, and withheld payroll taxes due while on the other hand long term liabilities include long term debt.

When it comes to the Statement of Financial Position, the question I get asked the most is;

“What is this deferred cash contribution and deferred capital contribution in the liability section of the Statement of Financial Position?”

Interestingly enough, these are two added complexities of not for profit accounting that the profit sectors never sees. The reason is that these two categories appear on your statements as a result of the fact that the organization has restricted funds (conditions that donors place on their contributions) amounts of cash. For example, grants that technically do not belong to your organization until the money is spent. Deferred cash contribution is simply the unspent amount of funds that are restricted for specific purposes. Deferred capital contributions are the remaining restricted funds spent on capital assets

that have not been amortized.

Statement of Change in Net Assets report accounts for any changes in net assets from one accounting period to the next. Moreover, it shows the organizations changes in wealth.

Statement of Operations report shows the amount of income earned over a period of time and the amount that was spent. In the Statement of Operations you may have one of three outcomes: revenue greater than expenses (Surplus), revenue less than expenses (Deficit), and revenue equals expenses (Breakeven Point). In essence, it informs you of how well the organization is operating. Comparing your Statement of Operations on a budget to actual basis while highlighting your variances on a monthly basis provides an effective mechanism for evaluating the organization's current position.

Statement of Cash Flow report shows all the funds flowing into the organization and flowing out of it during a certain period of time. The Cash Flow Statement groups activities into either operating, investing, or financing while focusing its attention on changes to Statement of Financial Position accounts. For the most part only auditors usually produce this statement.

Notes to Financial Statements are considered part of the financial statements and must be considered in their entirety when reading the statements. You will find details such as the organization's mission, information on significant accounting policies, and any commitments that the organization may have.

Not-for-profit organizations present their financial statements using either the deferral or restricted funds method. The deferral method recognizes the revenue of restricted contributions in the same period as the direct correlating expenses are recognized while the restricted funds method in its simplest form recognizes the revenue and expenses in the appropriate restricted fund. The majority of our organizations report their financial statements under the deferral method of accounting. If you require further assistance regarding the differences between the two methods please feel free to contact me.

At the end of the day, the types and frequency in which financial statements should be provided depends on its users and its economic situation. For example, banks may require reports more frequently to verify financial strength to pay back loans while funders or other donors may want reports to verify that donations are being spent appropriately by the organization.