

UNDERSTANDING AND READING FINANCIAL STATEMENTS



WAYNE KROEKER, MANAGER OF MEMBER SUPPORT

Whether you are serving on the board, the finance committee, or the audit committee of a church or charity, you should not leave all financial matters to those with accounting or financial backgrounds. It's important for everyone at the table to understand financial statements and contribute their own analysis. The following article provides some basic information on reading and understanding key financial documents. This will assist you in assessing your ministry's financial health.

There are five main components of a charity's Financial Statements that collectively provide a comprehensive picture of the organization's financial health:

1. The Statement of Financial Position (the Balance Sheet)
2. The Statement of Operations and Changes in Fund Balances (the Income Statement)
3. The Statement of Cash Flows
4. Notes to the Financial Statements
5. The Auditor's Report

Statement of Financial Position (BALANCE SHEET)

A Statement of Financial Position, also known as a Balance Sheet, is a snapshot of what the charity owns and owes at a fixed point in time. It includes details about the charity's assets, liabilities, and fund balances.

- **Assets** are the available resources that the charity owns, such as physical property (e.g., cash, investments, furniture, equipment, land, buildings) and intangible property (e.g., trademarks and other intellectual property). The assets are listed in liquidity order for ease of converting them into cash.
- **Liabilities** are the amounts that the charity owes (claims against the



resources). They can include loans from the bank, money owed for rent, supplies, equipment, payroll owed to employees, source deductions, and tax owed to the government.

- **Fund Balances** are the amounts left over if the charity sold all its assets and paid off all its debts. In other words, Total Assets less Total Liabilities equals Fund Balances. In a for-profit company, this money would belong to the shareholders or owners. In a not-for-profit (charity), it can only be spent on activities that further the charity's purpose and does not belong to the members.

A healthy Statement of Financial Position would have positive fund balances and enough cash or near cash to pay for its current liabilities. The reader should be able to distinguish external and internal restricted funds from non-restricted funds. They will also gain a better understanding of the specific funds by reading the Notes to the Financial Statements.

Since the Statement of Financial Position is a static report, it only shows where the charity is, not how it got there. **Figure 1** is an example of a typical Statement of Financial Position, breaking down the amounts by Fund, with a comparison of the prior year. In this example, for the current year, ABC

FIGURE 1

ABC Ministry
Statement of Financial Position
As at December 31, 20[]

	General Fund	Capital Fund	Missions Fund	Total [Current Year]	Total [Prior Year]
Current Assets					
Cash	\$ 21,500	\$ 4,000	\$ 3,000	\$ 28,500	\$ 25,000
HST receivable	500	-	-	500	1,000
Long Term Assets					
Land	-	50,000	-	50,000	50,000
Building	-	900,000	-	900,000	889,000
Total Assets	22,000	954,000	3,000	979,000	965,000
Current Liabilities					
Accounts payable	2,000	-	-	2,000	1,000
Deferred revenue	2,000	-	-	6,000	2,500
Total Liabilities	8,000	-	-	8,000	3,500
Fund Balances	14,000	954,000	3,000	971,000	961,500
Total Liabilities & Fund Balances	\$ 22,000	\$ 954,000	\$ 3,000	\$ 979,000	\$ 965,000

Ministry has total assets of \$979,000 and total liabilities of \$8,000 resulting in Fund balances totaling \$971,000. ABC Ministry has \$20,500 (\$28,500 - 8,000) available cash to be able to pay for its current liabilities of \$8,000. This is a positive indication of the ministry's financial health.

Statement of Operations and Changes in Fund Balances (INCOME STATEMENT)

The Statement of Operations and Changes in Fund Balances, also known as the Income Statement, shows how the charity got to where it is. It reveals the different sources of income or revenues (i.e., donations, sales, fees, interest income) and where the charitable funds have been applied or expended. The end result is either an Excess or Deficit of funds. This statement should also show that the Restricted Funds (i.e., Capital and Missions) are properly recorded and identified.

The beginning Fund Balances are then added to the Excess or Deficit for the year,

resulting in the end of year Fund Balances. This amount is then carried forward to the Statement of Financial Position. The end of year Fund Balances should always be equal to the Fund Balances listed on the Statement of Financial Position.

Figure 2 is an example of a Statement of Operations and Changes in Fund Balances for a ministry with several Restricted Funds. In this example, the end of year Fund balances are positive and greater than the beginning of year Fund balances, which is in and of itself an indicator of health. When you compare the Revenues and Expenses with the prior year, you can also see that the end results are more positive. Or stated another way, the Excess of Revenue of \$9,500 for the current year is greater than the Excess of Revenue of \$8,500 the prior year.

Statement of Cash Flows

The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and disbursements of an organization over the reporting period. In other words,

this report shows the sources (inflows) and the uses (outflows) of cash. It is a reconciling of information from the other financial statements and a barometer to monitor whether or not a charity has enough cash on hand to be able to pay its current expenses. The beginning of year and end of year Cash are also reconciled on this statement.

There are three parts to the Statement of Cash Flows:

- **Operating Activities** identifies the actual cash used in "operating activities" by deducting the amortization from the Net Income and reconciling Balance Sheet accounts from the previous year. For example, increases or decreases in Accounts Receivable, Accounts Payable.
- **Investing Activities** identifies cash used for purchasing property or equipment (capital assets), cash from the sale or purchase of investments, and cash received from the sale of gifts (e.g., publicly listed securities).

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FIGURE 2

ABC Ministry Statement of Operations and Changes in Fund Balances For the year ended December 31, 20[]

	General Fund	Capital Fund	Missions Fund	Total [Current Year]	Total [Prior Year]
Revenues					
Tax receipted gifts	\$ 205,000	\$ 1,000	\$ 13,000	\$ 219,000	\$ 215,000
Other gifts	4,000	-	500	4,500	5,000
Interest	500	-	-	500	400
Rental	-	3,000	-	3,000	4,700
Other	500	-	-	500	900
Total Revenues	210,000	4,000	13,500	227,500	226,000
Expenses					
Salaries & benefits	185,000	-	-	185,000	183,000
Building (occupancy) costs	12,000	-	-	12,000	11,500
Travel	2,500	-	10,000	12,500	12,000
Office supplies	3,000	-	3,000	6,000	6,000
Sunday school supplies	2,000	-	-	2,000	2,500
Other	500	-	-	500	2,500
Total Expenses	205,000	-	13,000	218,000	217,500
Surplus (deficiency) of revenue over expenses	5,000	4,000	500	9,500	8,500
Fund Balances, beginning of year	9,000	950,000	2,500	961,500	953,000
Fund Balances, end of year	\$ 14,000	\$ 954,000	\$ 3,000	\$ 971,000	\$ 961,500

- **Financing Activities** identifies where money was borrowed or repaid from a loan, mortgage, or line of credit.

Notes to Financial Statements

The notes are critical in helping the reader understand the financial statements. They should include the nature of the organization, such as its legal structure (i.e., incorporation), related organizations, purpose, income tax status, types of activities, and significant accounting policies. Some examples would be notes on designated

funds, property and equipment, investments, lease commitments, pension costs and commitments, contingent liabilities, and related party transactions.

Auditor's Report

The Auditor's Report usually explains that the financial statements are the responsibility of the management of the charity. The auditor performs the audit to obtain reasonable assurance that the statements are free of material misstatements. The auditor is responsible for providing the readers with an

opinion on whether the statements present fairly the financial position of the charity in accordance with Canadian accounting standards for not-for-profit organizations.

In conclusion, the Financial Statements are prepared so that the leadership or management of your organization can make informed, intelligent decisions that will influence the success or failure of the ministry. They also allow donors, members, and other stakeholders to assess the financial health of the charity and to hold the leadership and management accountable.

MUST-HAVE RESOURCES FROM CCCC

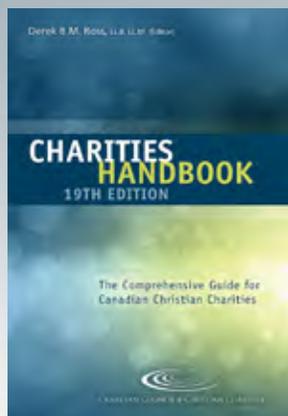
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	Hard copy	E-book
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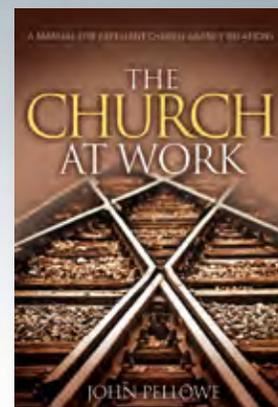


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