

# A GUIDE TO UNDERSTANDING THE FINANCIAL REPORTS OF NOT-FOR-PROFIT ENTITIES (NEW ZEALAND)

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CPA Australia Ltd  
ACN 008 392 452  
Level 20, 28 Freshwater Place  
Southbank Vic 3006  
Australia

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# CONTRIBUTORS

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CPA Australia acknowledges the contribution of the External Reporting Centre of Excellence.

## **External Reporting Centre of Excellence**

David Hardidge FCPA, Chairman

Jeffrey Luckins CPA

Indra Abeysekera CPA

Tong-Gunn Chew FCPA

Thomas Egan FCPA

Piotr Jakubicki CPA

Alan Lee CPA

Carmen Ridley

Ric De Santi FCPA

Julie Sinclair FCPA

Jessie Wong CPA

Jude Lau FCPA

## **Technical Support**

Ram Subramanian CPA

Eva Tsahuridu

# FOREWORD

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New Zealand's large and diverse not-for-profit sector has a strong history of helping vulnerable and disadvantaged people across a range of areas such as health, social services, education, human rights, welfare and the environment. The sector has the power to touch almost all New Zealanders in some way, either directly or indirectly through family, friends and colleagues.

The not-for-profit sector is also important to New Zealand's economy, employing a significant number of New Zealand's workforce. Many New Zealanders volunteer their time and expertise to the sector to make a positive difference.

*A guide to understanding the financial reports of not-for-profit entities (New Zealand)* will be of value to existing and prospective stakeholders, including those who work in not-for-profits, to better understand the accounting and regulatory aspects of not-for-profit financial reporting.

The Guide is an initiative of the External Reporting Centre of Excellence of CPA Australia and has benefited from the work of Grant Thornton, New Zealand. I congratulate them both on their contribution to this CPA Australia publication, which has an important role to play in the promotion of improved financial literacy.

**Alex Malley FCPA**

Chief Executive  
CPA Australia Ltd

# INTRODUCTION

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## THE PURPOSE OF THIS GUIDE

This guide is intended for the external users of financial statements prepared by not-for-profit (NFP) entities in New Zealand, such as members of NFP entities, donors and funding providers. In addition, the management and staff of NFPs may also find this guide useful. This guide will assist users to better understand the content of the financial statements and other accompanying documents of NFPs.

To assist understanding, in the appendix this guide provides extracts from the financial statements of Kiwiland City Mission, a fictitious charitable NFP entity providing lifeguard services and other beach-related activities for visitors to a popular Auckland beach. It should be noted that the example provided in the appendix does not constitute a full set of financial statements and the extracts are presented only to demonstrate key aspects of the financial statements of an NFP. In addition, this guide includes some general material about the New Zealand NFP sector, and a summary of the reporting changes that came into effect for entities with reporting periods beginning on or after 1 April 2015.

## A DIVERSE NFP SECTOR

The feature common to all NFPs is that they are not set up to generate a return for their members. That said, NFPs can and do generate profit or surplus. However, any profit or surplus cannot be distributed to members. Beyond this common feature, the differences in legal form, size, type and objectives are numerous.

The legal form of NFPs can be very different. Many are informal associations that are created by like-minded individuals with a common purpose, and do not take a particular legal form. These are commonly referred to as unincorporated associations.

Registered charities form one distinct subset of NFPs, with their objectives being primarily of a charitable nature. Charities operate for many purposes including relieving poverty, sickness or the needs of the aged, advancing education, advancing religion and other purposes beneficial to the community. Examples that would fall within the other purposes category include providing NFP childcare services, advancing arts and culture, health, promoting animal welfare and protecting the environment. An overwhelming

majority of NFPs are not charities and they can exist for the exclusive benefit of members, or to serve a specific group of people, community or purpose. Examples include clubs formed for a social, recreational or sporting purpose, and professional and trade associations.

## LAWS AND REGULATIONS

The activities NFPs are involved in often have a profound social and economic impact and some NFP entities such as charities exist solely to engage in activities that are for the public benefit. Many NFP entities rely on financial support from government and the philanthropy of private benefactors to achieve their objectives. As a result of these unique attributes, laws and regulatory frameworks have been developed over the years by the Government to regulate the NFP sector. Some of these laws include provisions setting out governance and reporting requirements. Examples in New Zealand include the *Incorporated Societies Act 1908* and the *Charities Act 2005*.

## WHY ARE FINANCIAL STATEMENTS REQUIRED?

Depending on the structure of the NFP, its governing legislation may require periodic financial reporting as part of its governance obligations. Funding providers (both private and government) often require financial statements as part of their acquittal process. Members and other stakeholders can also impose financial reporting obligations through an NFP's constitution or other means. Financial statements are also used for internal purposes by the management and staff. However, the needs of internal users and those of external users, for whom this guide has been written, are not necessarily the same.

Financial reporting by NFPs provides information to users to demonstrate effective stewardship and accountability, and to assist their decision-making. NFPs are normally accountable to those that provide them with resources, and those that depend on them for the services or goods they provide.

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The financial reporting by NFPs provides information on how they have discharged their accountability obligations about the management of the resources entrusted to them for the delivery of services or goods to stakeholders, and compliance with legislation, or other authority that governs the delivery of services or goods and other operations. Financial reporting by NFPs is also intended to aid users by providing information that assists them in deciding whether or not to provide resources including financial resources. For example, a private donor looking to make a significant monetary donation to a charity may examine and analyse its financial statements to establish the financial performance and stability of the entity before making a donation.

Often NFP financial statements are independently audited or reviewed. This may be undertaken to comply with statutory or other requirements, or voluntarily by the NFP.

An audit or review provides additional comfort or assurance to users about the accuracy of information contained in the financial statements.

The form and content of financial statements prepared by NFPs can vary significantly depending on their size, type, and statutory or other requirements. This guide includes excerpts from the financial statements of a small to medium-sized charitable NFP reporting under Tier 2 of the financial reporting framework implemented for entities with accounting periods beginning on or after 1 April 2015. This guide also makes reference to smaller NFPs who are able to produce accounts on a cash accounting basis, and to those able to prepare their financial statements under the Special Purpose Financial Reporting Framework (SPFR).

# WHAT ARE FINANCIAL STATEMENTS?

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Most people use the terms “financial statements”, “financial report” and “annual report” interchangeably when talking about the annual documents produced by NFPs. However, the reality is that the terms financial statements and financial report have special legal meanings that are contained in various laws applicable to NFPs across New Zealand. The term annual report is less defined but is generally considered to include all documents that are prepared annually by an NFP to inform readers about its activities and achievements, performance and financial position for the year.

Normally the annual report will incorporate the financial report and financial statements, as well as other information.

The following illustration demonstrates the relationship between the financial statements, the financial report and the annual report, and provides examples of the common content contained in these documents. It should be noted that not all the examples of content provided below will always be included, as this will depend on a number of factors, including the size of the NFP, accounting basis adopted, applicable legislation or other requirements and accounting standards applied in preparing the financial statements, financial report or annual report.

## Illustration 1

### ANNUAL REPORT:

- Chairman’s statement
- Statement of service performance report

### FINANCIAL REPORT:

- Audit report or review report
- Management committee report
- Notes to the financial statements

### FINANCIAL STATEMENTS:

- Statement of comprehensive revenue and expenses
- Statement of financial position
- Statement of changes in net assets
- Statement of cash flows



## FINANCIAL STATEMENTS AND FINANCIAL REPORTS

Financial statements will typically provide financial information about the NFP's financial performance over a period of time (commonly a financial year) and the financial position at the end of that period of time. Other information that may be presented in financial statements includes information on the cash flows arising during the year.

As stated earlier, the form and content of financial statements will depend on the criteria applied in their preparation, as well as whether (or not) the entity is required to prepare its financial statements in accordance with Generally Accepted Accounting Principles (GAAP).

In New Zealand, registered charities are required to prepare their financial statements in accordance with the four-tier framework (as set out below). NFPs that are not registered charities, are able to prepare their financial statements in accordance with the SPFR (unless they elect to prepare their financial statements in accordance with the four-tier framework issued by the External Reporting Board (XRB)).

The four-tier framework, and the various size criteria applied are as follows:

TIER	ENTITIES	ACCOUNTING STANDARDS APPLIED
Tier 1	Publicly accountable <b>or</b> the entity is large (defined as total expenses > \$30m)	PBE IPSAS
Tier 2	Not publicly accountable <b>and</b> the entity is not large (defined as total expenses between \$2m and \$30m)	PBE IPSAS Reduced Disclosure Regime (RDR)
Tier 3	Not publicly accountable <b>and</b> Total expenses between \$125k and \$2m	Simple format reporting prepared on an accruals basis
Tier 4	Not publicly accountable <b>and</b> Total expenses < \$125k	Simple format reporting prepared on a cash basis

International Public Sector Accounting Standards (IPSAS) provide the basis for many of the new standards issued by the XRB for NFP entities. However, they are referred to as Public Benefit Entity International Public Sector Accounting Standards (PBE IPSAS). These accounting standards have been tagged as PBE IPSAS because they have been adapted from the “pure” IPSAS now used by more than a dozen countries around the world.

In addition to the PBE IPSAS standards, the XRB has issued simple format financial reporting guidelines for tier 3 (using an accruals basis of reporting) and tier 4 (using a cash basis of reporting). These tiers have been introduced in order to reduce the compliance costs for smaller registered charities which are often not as complex as their larger counterparts.

Further information and guidance on the four-tier framework can be found on the [XRB website](#).

Illustration 1 includes the four primary statements that will be included in financial statements that are prepared in accordance with accounting standards applicable to Tier 1 and Tier 2 entities. The excerpts from the financial statements of the fictitious NFP entity Kiwiland City Mission provided in the appendix include examples of the four primary statements.

- The statement of **comprehensive revenue and expenses** (also referred to as the statement of financial performance, statement of receipts and payments, profit and loss account, or income statement) provides information on the entity’s financial performance by reporting the financial (or monetary) value of all events that have changed the value of the assets and liabilities of the NFP. These changes in value are represented as items of income and expenditure (or receipts and payments) with the net difference presented normally as a surplus or deficit (some NFP entities also use the terms profit or loss instead, which is the standard terminology used by a profit-oriented entity).
- The statement of **financial position** (also referred to as statement of resources and commitments, or balance sheet) shows the monetary measure of all the resources controlled by an NFP (assets) and all the obligations due by the NFP (liabilities) at the year-end, classified as current or non-current in order of liquidity.
- The statement of **changes in net assets** (also referred to as the statement of changes in equity) reports all changes in the reserves (or funds) held by the NFP during the financial period.
- The statement of **cash flows** shows the cash inflows and outflows for the financial period from operating, investing and financing activities.

The term financial report (referred to as a “performance report” tier 3 and 4 entities) is often used interchangeably with the term financial statements, but normally denotes the document that incorporates the financial statements and some additional information arising from legislative or other requirements. For example, in a *Companies Act* setting, a financial report will, in addition to the financial statements, include the notes to the financial statements and a declaration by the directors. Other common content considered part of financial reports includes:

- **Audit report or review report:** the report by the auditor or reviewer sets out their conclusions drawn in the form of an audit or review opinion, and a brief background on respective responsibilities of the auditor or reviewer and basis for arriving at the opinion. The different types of conclusions and the level of assurance an auditor or reviewer draws and expresses through their opinion are provided in the section “Audit/review of NFP financial statements”.

- **Management committee report (or trustees' report, or equivalent):** the group of individuals entrusted with the governance of the NFP may be referred to as the board, trustees, or management committee, and the report they provide will reflect their title. The management committee report (or equivalent) will normally include names of the management committee members (or trustees or equivalent), a review of the operations and activities of the NFP, objectives of the NFP and the strategies to achieve these objectives. Risks faced by the entity, and future plans may also be included in the report.
- **Entity information** is required for tiers 3 and 4, to summarise for users what the entity does and how it is organised. This information will assist users in their understanding of the entity and help particularly with their interpretation of the performance report.

## ANNUAL REPORT

In addition to content included in the financial statements and financial report, and depending on the legislative or other requirements, the content of an annual report can vary. Commonly information contained in the annual report above and beyond information in the financial report will fall outside the scope of an audit or review. A synopsis of common types of content included in the annual report is provided below:

- **Chairman's statement:** this document is normally voluntary, providing a high-level overview of the entity's performance, activities and strategies. The chairman's statement is normally an "impact" document appearing at the front-end of the annual report to showcase an entity's achievements and outcomes.
- **Statement of service performance:** financial statements normally include information about an NFP's financial performance and financial position. Increasingly, information about an entity's non-financial performance is also being included to demonstrate to stakeholders how an entity has performed in achieving its objectives. This narrative approach to performance reporting is particularly relevant to NFPs. Unlike a profit-oriented entity with an objective of providing a return to its investors, NFPs can have a range of different objectives. For example, a golf club's objectives may be to provide a range of golf-related and other recreational services to its members, whilst an aged care charity might focus its objectives on providing specialist care services. The non-financial metrics and discursive information provided in a service performance report can enable an NFP to demonstrate how it has performed in achieving its objectives. Note, a statement of service performance is required for all tier 3 and 4 entities and forms part of the performance report. There is currently no requirement for tier 1 and 2 entities to prepare a statement of service performance although this is expected to become a requirement for tier 1 and 2 entities at a future date.

# IMPORTANT FEATURES OF NFP FINANCIAL STATEMENTS

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## TYPES OF FINANCIAL STATEMENTS

Within the NFP sector, significant differences exist in the form and content of financial statements (or financial reports) prepared by different NFPs. These differences arise due to the wide range of activities NFPs are involved in, the needs of different stakeholders, the legal form of the NFP, and the different laws and regulations that apply to NFPs. Some common differences in types of financial statements are explored below.

### FINANCIAL STATEMENTS PREPARED ON A CASH BASIS OF ACCOUNTING VS. AN ACCRUALS BASIS OF ACCOUNTING

#### Cash basis of accounting

Only NFPs with expenses less than \$125,000, and that are not publically accountable, may report under the Simple Format Reporting – Cash framework. Under this most simple method of accounting, only the cash receipts and cash payments are recorded and presented in the statement of receipts and payments. Cash balances at the end of the financial year (at the bank and on hand) are also presented alongside the statement of receipts and payments. Financial statements presented on a cash basis also include a statement of resources and commitments to set out details of other resources controlled and associated commitments. Such additional information presented is usually easily obtainable without the need to rely on expert accounting knowledge.

#### Accruals basis of accounting

The accruals basis of accounting is widely accepted as the more appropriate method for preparing financial statements, and all entities with expenditure greater than \$125,000 report on this basis. Under the accruals basis, income is recognised when it is earned and expenditure is recognised when it is incurred. Therefore, income recognised will include cash that has not yet been received but the entity has earned a right to it, either through delivery of services or goods, or through a binding commitment from a third party. Expenditure recognised will include costs incurred but not yet paid, where either goods or services have been received or binding obligations have been committed to. Expenses also include depreciation, which is an annual expense to reflect an entity's use of its assets such as furniture and fittings, buildings, computer equipment and other such assets. In addition to physical assets and cash, assets and liabilities recognised will include other financial assets such as debtors (receivables for earned income not yet received at the end of the financial year) and, financial liabilities such as creditors (payables for expenditure incurred and services used that have not yet been paid at the end of the financial year).

Sometimes an NFP will be the parent entity in a group, controlling one or more other entities (called subsidiaries, which can be NFPs or for-profit entities). The parent entity of a group preparing financial statements in accordance with accounting standards will prepare and present consolidated financial statements that include the financial information for all the entities within that group.

## FEATURES OF EACH OF THE FOUR TYPES OF PRIMARY STATEMENTS THAT CAN BE INCLUDED IN FINANCIAL STATEMENTS

The content of the financial statements of an NFP differ from a profit-oriented entity's financial statements in a number of ways. This is due to the unique activities and objectives of NFPs and the different information needs of users of NFP financial statements. The applicable legal and regulatory frameworks can also give rise to differences in the content of the NFP financial statements. Highlighted below are some of the unique features within the four primary statements that can form part of an NFP's financial statements.

### STATEMENT OF COMPREHENSIVE REVENUE AND EXPENSES (ALSO REFERRED TO AS THE STATEMENT OF FINANCIAL PERFORMANCE, STATEMENT OF RECEIPTS AND PAYMENTS, PROFIT AND LOSS ACCOUNT, OR INCOME STATEMENT)

NFPs can generate income for the pursuit of their objectives by obtaining funds from providers, who do not receive any direct benefit in return for the provision of funds. NFPs can also generate income in a similar way to profit-making entities, by earning revenue in return for the provision of goods or services. The example statement of comprehensive revenue and expenses of Kiwiland City Mission on page 23 includes income types common to NFP entities, such as:

- **Grants** – Government agencies and private sector entities may provide grants to NFPs to either carry out the activities they are set out to undertake, or for specific prescribed activities.
- **Donations** – Philanthropy is a significant source of funds for the NFP sector and income received as donations is a common element of income for NFPs. Donations can either be received for the general activities and objectives of an NFP, or to fund particular activities. Bequests, gifts, legacies and endowments all fall within the category of donations. Whilst donations can take monetary form, donations in kind are also common, including donated goods and services. Volunteers' time would normally be classified as donations in kind. NFPs can often find the valuation of donations in kind to be challenging, especially those with limited resources and accounting and valuation

expertise. It can be further complicated when comparable or benchmark information on financial value is not available. Kiwiland City Mission receives donations in kind, in the form of donated goods, as can be seen in the revenue note 5 on page 27.

- **Fundraising income** – NFPs may also generate income through fundraising events (for example, a school fee) or activities (such as a raffle). Whilst some fundraising activities will involve provision of goods or services in return for income, other activities may not. In order to undertake fundraising activities, NFPs are also commonly required to obtain a license and comply with fundraising legislation, which can include financial reporting obligations. Note 5 in Kiwiland City Mission's financial statements on page 27 indicates that it receives fundraising income (fundraising appeals).
- **Membership income** – Subscriptions or fees paid by members of an NFP often allow members to enjoy certain benefits and facilities provided by the NFP. Entities will need to determine how this revenue is most appropriately recorded, either on receipt or spread over a period of time. Recognition can depend on what the members get in return from the NFP for the subscriptions or fees paid, and the basis of accounting adopted by the NFP (cash basis or accruals basis).
- **Trading income** – Many NFPs operate trading facilities (such as a shop or bar) as part of their activities, with the profits or surplus generated from such activities utilised for the primary objectives of the NFP. The trading activities of Kiwiland City Mission ascertained from its statement of comprehensive revenue and expenses on page 23 include shop income and medical / detox centre revenue.
- **Investment income** – NFP entities may hold investments that generate income for a number of reasons. Some may do so as part of their overall strategy to achieve their objectives, or even as a requirement set out in their constitution. Others may acquire investments from time to time when they have excess funds that are earmarked for future expenditure. Kiwiland City Mission's statement of comprehensive revenue and expenses on page 23 indicates that it receives investment income.

In order to conduct its activities an NFP will incur expenditure, which is presented in the statement of comprehensive revenue and expenses. Expenses can either be analysed by their nature (such as transport costs, employee expenses and depreciation) or by their function (for example, cost of sales, cost of distribution or administrative expenses). The example statement of comprehensive revenue & expenses on page 23 uses the “nature of expense” method and the descriptions used for the expenses presented are self-explanatory.

#### **STATEMENT OF FINANCIAL POSITION (ALSO REFERRED TO AS STATEMENT OF RESOURCES AND COMMITMENTS, OR BALANCE SHEET)**

NFPs may hold and operate a range of different assets that provide them with economic benefits. Some of these assets that are held, and provide benefit, over the long term are classified as non-current assets. Assets that provide benefits over the short term (usually within one year) are classified as current assets. In fulfilling their objectives, NFPs also enter into commitments and obligations that give rise to liabilities. Similar to assets, liabilities are either current (short term, usually requiring settlement within the following financial year) or non-current (due after more than one financial year). The difference between assets and liabilities (net assets or net liabilities) represents the equity the NFP holds. Some common features of the assets and liabilities of an NFP and some of the challenges in relation to the measurement and presentation of the financial values represented by these assets and liabilities are discussed below.

- **Asset values and impairment** – Operational non-current assets held by NFPs (land, buildings and other property, plant and equipment) are often utilised for purposes that may not represent the best financial return. In particular, a commercial return is often not charged. For example, a charitable NFP, as part of its objective to provide poverty relief, may own a property that is used to provide subsidised or free accommodation to homeless individuals, rather than charge market rates. Where an entity chooses to carry its non-financial asset at fair value, rather than at cost, PBE IPSAS 17 Property Plant and Equipment Fair Value Measurement requires the fair value measurement to reflect the “highest and best use” for that asset, which requires consideration of uses that are physically possible, legally permissible and financially feasible. NFPs that fair value non-financial assets and hold and use such assets for what may be less than financially optimal purposes may encounter challenges in measuring such assets at fair value. More information on issues relating to the valuation of assets in the NFP sector can be obtained from the CPA Australia guide *Valuation and depreciation: A guide for the NFP and public sector under accrual-based accounting standards*.
- **Heritage assets** – Some NFPs hold assets of heritage or artistic value (such as art collections, heritage buildings or park land) that give rise to valuation challenges.
- **Investment assets** – NFPs can hold investments that provide them with a financial return to fund their activities. Investment assets can include financial investments (such as shares or bonds) or investment property. Investment assets can either be donated to the NFP or acquired by the NFP to further its objectives.
- **Equity, funds or reserves** – The net financial value of assets less liabilities that an NFP holds can be split amongst various classes of equity, funds or reserves. A general (or retained) reserve is the most common type of reserve that represents the common pool of net assets available to the NFP to fulfil its general objectives. An NFP adopting an accounting policy of presenting some of its assets on a revalued basis will also include an asset revaluation reserve that includes the cumulative revaluation gains or losses arising on the revalued assets.

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**STATEMENT OF CHANGES IN NET ASSETS**

A statement of changes in net assets (or statement of changes in funds or reserves) will normally provide information on changes in the funds or reserves of an NFP, including opening and closing balances, net surplus or deficit (profit or loss) and transfers between funds (where permitted).

**STATEMENT OF CASH FLOWS**

A statement of cash flows provides information on the cash inflows and outflows of the NFP, classified by different types of cash flows. As illustrated in the example on page 26, the statement of cash flows can include cash flows from operating activities, investing activities and financing activities.

The descriptions used for the three main categories of cash flows in the statement of cash flows are self-explanatory. Cash flows from operating activities will include cash receipts (inflows) and payments (outflows) from the day-to-day operations of the NFP. The example on page 26 includes interest and dividend income under investing activities, however entities have a choice (which they have to apply consistently every year) on whether such cash flows should be included under operating activities or investing activities. Cash flows from investing activities will normally include payments and receipts on purchase and disposal of investments. Cash flows from financing activities for an NFP will normally include capital injections from members, loans received and loans paid, repayments bank loans it owed also come under this category.

# AUDIT/REVIEW OF NFP FINANCIAL STATEMENTS

Financial statements can be audited or reviewed for a number of reasons. Examples include obligations arising from applicable legislation, requirements placed by funding providers, or a requirement arising from an NFP's own constitution or its members.

The *Charities Act 2005* sets out the following audit and review requirements for registered charities:

ENTITIES	REQUIRED TO HAVE AN AUDIT OR REVIEW
Large charities (total expenses > \$1m)	Yes – Must be audited by a qualified auditor
Medium charities (not large and with total expenses > \$500k)	Yes – Must be reviewed (but can elect to have an audit) by a qualified auditor
Small charities (total expenses < \$500k)	No

The level of comfort that a user can derive from an audit and a review differs. An audit will normally enable the auditor to obtain a higher or reasonable level of assurance in arriving at audit conclusions that will form the basis of the auditor's opinion expressed in the audit report. In a review engagement, the reviewer will normally undertake a less detailed engagement compared to an audit, that enables the reviewer to obtain a limited level of assurance in arriving at the conclusions that will form the basis of the reviewer's opinion expressed in the review report.

It should be noted that "absolute" or "total" assurance (such as a certification that the financial statements are completely correct) cannot be achieved through an audit (or review). The XRB provide the framework for conducting audits in New Zealand. An audit performed by applying the ISAs (International Auditing Standards (New Zealand)) is designed to enable the auditor to identify material inaccuracies or misstatements in the financial report and results in an opinion by the auditor on whether the financial report presents fairly (or gives a true and fair view of) the financial position, financial performance and cash flows (as applicable) of the entity, in all material respects. If stipulated by legislation or other requirements, the auditor may also state in the audit report whether the financial report is prepared in accordance with applicable accounting standards and legislation.

The XRB issues New Zealand standards for review engagements to assist in the conduct of review engagements. The opinion arising from a review engagement is normally in a negative form, for example, the reviewer will provide a conclusion that nothing has come to their attention to indicate that the financial report does not present a true and fair view.



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The following table summarises example auditor and reviewer opinions.

TYPE	EXAMPLE OPINION
Audit	In our opinion, the financial statements on pages 1 to 15 present fairly, in all material respects, the financial position of XYZ Incorporated as at 30 June 2015, and its financial performance and its cash flows, for the year then ended in accordance with generally accepted accounting practice in New Zealand.
Review	Based on our review, nothing has come to our attention that causes us to believe that these 30 June 2015 financial statements of XYZ Incorporated do not present fairly, in all material respects, the financial position of the Society as at 30 June 2015, and of its financial performance and its cash flows for the year ended on that date, in accordance with [applicable financial reporting framework]

# HOW TO READ NFP FINANCIAL STATEMENTS

There are similarities and differences in the information needs of users of NFP financial statements, and the information needs of users of for-profit financial statements. The following table illustrates some of the key differences and similarities.

Common questions asked by users of for-profit financial statements	Common questions asked by users of NFP financial statements
<ul style="list-style-type: none"> <li>• What is the profit (or loss) made by the entity in the financial year?</li> <li>• What is the financial strength of the entity?</li> <li>• Does the entity generate a satisfactory return on my investment?</li> <li>• Does the entity have a viable and sustainable future?</li> <li>• Is this an entity I can invest in, or lend money to?</li> <li>• How effective is the entity's management?</li> </ul>	<ul style="list-style-type: none"> <li>• How well has the entity performed in meeting its objectives?</li> <li>• What is the financial strength of the entity?</li> <li>• Has the entity fulfilled its commitments in exchange for funds received?</li> <li>• Does the entity have a viable and sustainable future?</li> <li>• Is this an entity (or activity undertaken by the entity) I want to donate to or contribute funds to?</li> <li>• How effective is the entity's management?</li> </ul>

As noted above, there are similarities and differences in questions asked by users of the two types of financial statements. Although some of the questions can be similar, the underlying reasons for asking these questions may differ. For example, the user of a for-profit entity financial report may seek to know how well the entity is being managed in generating returns for its investors, whilst the same question may be asked in an NFP scenario to establish if the entity is fulfilling its objectives satisfactorily.

## STEP 1 – UNDERSTANDING THE ENTITY

Before commencing the analysis of an NFP's financial report, it is important to obtain a good understanding of the entity, including their:

- **Primary objectives, governance structure, and area of operation and activities** – This information can be obtained from sources such as the NFP's governing document (such as constitution or trust deed), from the management committee's (or equivalent) report, or the chairman's report. The NFP's governing document may be obtainable from the NFP, or in some cases from a public source such as the [Charities Services online portal](#).
- **Legal form** – NFPs operate under various legal structures, including incorporated societies, companies, trusts and co-operatives. As stated earlier, some entities are not formed under any particular legislation or statute, and are commonly referred to as unincorporated societies.

As stated above, an understanding of the entity can be obtained by reading some parts of the annual report. Some NFPs include a chairman's report or a statement of service performance (required for tier 3 and 4 entities) in their annual report (or performance report). The content of these reports usually includes a discussion of the entity's performance highlights in the context of its objectives. Whilst reading these reports, users should be mindful that an audit or review would not normally extend to the information contained in them and an objective and analytical approach is recommended when considering such information.

## STEP 2 – THE AUDIT REPORT OR REVIEW REPORT

The opinion of the auditor or reviewer can provide further insight into the veracity of the information presented in the financial statements. In an earlier section, we considered the difference between an audit engagement and a review engagement and the differences in the opinions provided by the auditor and the reviewer in their respective reports. If the auditor concludes at the end of the audit engagement that the financial report presents fairly or gives a true and fair view, the audit report will reflect this opinion. If required, the auditor may go on to state that the financial report is prepared in accordance with accounting standards and legislation (as appropriate). This is sometimes referred to as an unqualified or clean opinion.

If a reviewer concludes at the end of the review engagement that the financial report presents fairly or gives a true and fair view, the reviewer will provide a conclusion that nothing has come to his or her attention that the financial report does not present a true and fair view. Additional statements about compliance with accounting standards and legislation may also be provided if required.

Sometimes, an auditor or reviewer may conclude either that the financial statements contain a material misstatement, or that the auditor or reviewer has been unable to gather sufficient evidence to form an opinion. Users of financial statements should carefully read the audit report or review report to identify if the opinion has been modified or “qualified” as a result, and also read carefully why the auditor or reviewer has issued such an opinion. For example, a situation that can sometimes arise in the NFP sector that gives rise to a modified opinion is when material cash donations are received. Auditors and reviewers can encounter practical difficulties in gathering sufficient evidence over the completeness of income received from cash donations due to the manner in which such donations are generated (such as through street collections). In such instances, auditors and reviewers may seek alternative sources of evidence and perform alternative testing procedures. This could be achieved by testing and placing reliance on good internal controls, but if this is not possible, a modified or qualified opinion may be issued by the auditor or reviewer.

Auditors or reviewers may also include emphasis of matter paragraphs. Whilst such paragraphs do not denote a qualified audit or review report, they are included to highlight certain aspects the auditor or reviewer believes are important to draw to the reader’s attention, for an understanding of the financial statements. Such emphasis of matter paragraphs may, for example, be included when an audit or review highlights material uncertainties over the continuing ability of the NFP to operate into the foreseeable future (commonly referred to as the going concern assumption).

## STEP 3 – READING THE FOUR PRIMARY STATEMENTS

Earlier sections contained a discussion of the types of financial information provided through each of the four primary statements that constitute the entity’s financial statements, and some of the common elements and features. The following sections consider how to assess the NFP’s financial performance and financial position through the four primary statements.

### STATEMENT OF COMPREHENSIVE REVENUE & EXPENSES

The statement of comprehensive revenue and expenses sets out the income earned, expenditure incurred and the net surplus or deficit for the financial period. The level of detail for income and expenditure can vary, with some entities providing more detail on the face of the statement, whilst others provide detail in the notes. The statement of comprehensive revenue and expenses for Kiwiland City Mission is an example where some level of detail is provided through the line items presented for income and expenditure. In addition to the income and expenditure for the current period, the income and expenditure for the prior period is also provided to enable comparison of financial performance from the last period to the current period. Provision of comparative figures is a requirement of accounting standards.

When considering the surplus (or deficit) of an NFP it is important to be mindful of two features specific to NFPs:

- The focus of an NFP is not to generate a surplus (or profit) for the benefit of its members and it is not uncommon for an NFP to consistently achieve small surpluses (or deficits) every year.
- Even if a significant surplus (or deficit) is achieved in a particular financial year, this does not necessarily indicate good or bad financial performance in that year. The information should be considered in conjunction with other information in the financial report that may provide an explanation for the surplus (or deficit). It is common for grants received by NFPs to be recognised when received, and the related expenditure recognised when incurred in subsequent years. This can result in a timing mismatch of the grant receipt and the related expenditure. Consequently, a surplus could arise in the year the grant is received and recognised, and a deficit could arise when the related expenditure is incurred and recognised. So in order to obtain a proper appreciation of the reason for significant surpluses (or deficits), it is important to assess the information provided in the other primary statements and notes to the financial statements.

A note of warning, however; when analysing income and expenditure for specific activities, bear in mind that while the direct expenses relating to specific activities may be identifiable, general overhead expenditure incurred by the NFP may not be allocated to expenses relating to specific activities.

In addition to income and expenditure, the statement of comprehensive revenue and expenses also includes other gains and losses generated during the year. These other gains and losses are not included in the calculation of the surplus or deficit arising. One example is a revaluation gain on a non-financial asset, such as land. Because the revaluation gain is not available as a resource to the entity until the asset is disposed, the gain is not included in calculating the NFP's surplus or deficit.

#### STATEMENT OF FINANCIAL POSITION

The statement of financial position provides information on the assets and liabilities of the NFP, and the reserves or funds these assets and liabilities represent. Some asset values are included on the historical cost basis. This represents the cost of the asset, less depreciation or amortisation (the financial value representing economic consumption of the asset). Kiwiland City Mission assets included in property, plant and equipment are included on the historical cost basis, as set out in the extract of note 15 on page 27-28.

The difference between the asset values between 2014 (\$10,410k) and 2015 (\$7,678k) is the depreciation charge of \$107k for 2015 presented in the statement of comprehensive revenue and expenses along with additions (\$80k), disposals (\$5k) and reclassifications (2,700k) as set out in note 15.

Other assets are included at fair value, which represents the market value that the NFP would obtain if it were to dispose of the asset at the year-end date. Liabilities are usually included at historical cost. Kiwiland City Mission does not hold any assets or liabilities that are presented at their fair value.

Current assets are assets that the NFP expects to recover or realise within the following financial year. Non-current assets can normally be recovered or realised over a longer period, after more than one financial year. Some non-current assets are held with no intention to dispose of but to put to use in conducting the activities of the NFP. Physical assets such as property, plant and equipment are such assets. For example, the land a golf club owns and operates for the playing of golf by its members is likely to be held for a number of years by the club.

Financial assets can either be current assets (such as cash held at the bank) or non-current assets (such as long-term investments held for a return). Similarly, non-financial assets can either be current (such as inventories) or non-current (such as property). Liabilities are classified similarly and are presented as current and non-current liabilities on the statement of financial position.

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The statement of financial position can provide useful insights into the financial strength of an NFP. The net assets (total assets less total liabilities) of Kiwiland City Mission amounted to \$25,090k in 2015 and \$21,737k in 2014. Excluding non-current assets and non-current liabilities, the net current assets of Kiwiland City Mission (current assets less current liabilities) are \$3,776k in 2015 and \$1,457k in 2014.

**STATEMENT OF CASH FLOWS**

In contrast to the statement of comprehensive revenue and expenses, the statement of cash flows presents the actual inflows and outflows of cash from the entity's various activities. Some of these cash flows will relate to income and expenditure for the year (for example, grants received or salaries paid) whilst other cash flows relate to items in the statement of financial position (such as the acquisition of investments).

**STATEMENT OF CHANGES IN NET ASSETS**

The statement of changes in net assets presents the reserves (or funds) held by the NFP (in the form of assets and liabilities) to meet its objectives. The reserves can be presented individually in the statement of changes in net assets, or alternatively a summary is presented in the statement, with further details provided in the notes. The statement shows the balances brought forward of the amount held in the reserves, the movements in and out during the year, and the balances carried forward. The movements include the surplus or deficits arising during the year and any transfers between funds during the year.

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# APPENDIX

## EXAMPLE EXTRACTS FROM FINANCIAL STATEMENTS

(Note – Examples extracted from a fictitious tier 2 reporting entity)

**KIWILAND CITY MISSION  
STATEMENT OF COMPREHENSIVE REVENUE  
AND EXPENSES  
FOR THE YEAR ENDED 30 JUNE 2015**

	Notes	Group 2015 \$000	Group 2014 \$000
<b>Revenue from non-exchange transactions</b>			
Donations	5	5,012	4,592
Grant revenue		1,181	1,202
Government contract revenue		636	597
Legacies/bequest		1,776	205
		8,605	6,596
<b>Revenue from exchange transactions</b>			
Investment income		28	30
Second hand shop sales revenue		514	487
Interest revenue		97	86
Medical and detox centre revenue		258	179
Other operating revenue		81	75
		978	857
<b>Total revenue</b>		<b>9,583</b>	<b>7,453</b>
<b>Expenses</b>			
Second hand shop operating expenses		222	217
Administration cost		1,003	1,040
Fundraising expense		428	419
Social Services cost	8	5,770	5,637
Redevelopment project cost	7	77	1,144
Interest expense		7	9
Other operating expenses		163	202
<b>Total expenses</b>		<b>7,670</b>	<b>8,668</b>
Share of profit in equity accounted associate		518	917
<b>Total surplus/(deficit) for the period</b>	6	<b>2,431</b>	<b>(298)</b>
<b>Other comprehensive revenue and expenses</b>			
Revaluation of land and buildings		922	
<b>Total comprehensive revenue and expense</b>		<b>3,353</b>	<b>(298)</b>
Surplus or (deficit) attributable to the owners of the controlling entity		2,431	(298)
<b>Total comprehensive revenue and expense attributable to the owners of the controlling entity</b>		<b>3,353</b>	<b>(298)</b>

**KIWILAND CITY MISSION  
STATEMENT OF CHANGES IN NET ASSETS  
FOR THE YEAR ENDED 30 JUNE 2015**

<b>Group</b>	<b>Asset revaluation reserve</b>	<b>Restricted equity reserve</b>	<b>Special purpose reserve</b>	<b>Retained surplus</b>	<b>Total equity</b>
		<b>\$000</b>	<b>\$000</b>	<b>\$000</b>	<b>\$000</b>
Opening balance 1 July 2014		764		20,973	21,737
Surplus/(Deficit) for the year				2,431	2,431
Other comprehensive income	922				922
Transfers		21	1,915	(1,936)	
<b>Closing equity 30 June 2015</b>	<b>922</b>	<b>785</b>	<b>1,915</b>	<b>21,468</b>	<b>25,090</b>
Opening balance 1 July 2013		743		21,292	22,035
Surplus/(Deficit) for the year				(298)	(298)
Other comprehensive income					
Transfers		21		(21)	
<b>Closing equity 30 June 2014</b>		<b>764</b>		<b>20,973</b>	<b>21,737</b>



**KIWILAND CITY MISSION  
STATEMENT OF FINANCIAL POSITION  
FOR THE YEAR ENDED 30 JUNE 2015**

	Notes	Group 2015 \$000	Group 2014 \$000
<b>Current assets</b>			
Cash and cash equivalents	11	1,690	1,729
Short term investments		2,147	
Investments	12	270	262
Receivables from exchange transactions	13	157	195
Receivables from non-exchange transactions		35	33
Prepayments		31	26
Inventories		105	85
		<b>4,435</b>	<b>2,330</b>
<b>Non-current assets</b>			
Investment properties	14	4,180	580
Property plant and equipment	15	7,677	10,410
Equity accounted investees	16	9,457	9,290
		<b>21,314</b>	<b>20,280</b>
<b>Total assets</b>		<b>25,749</b>	<b>22,610</b>
<b>Current liabilities</b>			
Trade and other creditors		356	279
Deferred income		37	263
Employee entitlements		266	331
		659	873
<b>Total net assets</b>		<b>25,090</b>	<b>21,737</b>
<b>Total net assets</b>			
Net assets			
Asset revaluation reserve	9	922	764
Restricted equity reserve	9	785	
Special purpose reserve	9	785	
Retained surplus		<b>21,468</b>	<b>20,973</b>
<b>Total net assets attributable to the owners of the controlling entity</b>		<b>25,090</b>	<b>21,737</b>

Signature

**KIWILAND CITY MISSION  
STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 30 JUNE 2015**

	Notes	Group 2015 \$000	Group 2014 \$000
<b>Cash flows from operating activities</b>			
<b>Receipts</b>			
Receipts from non-exchange transactions		6,048	3,947
Receipts from exchange transactions		695	649
		<b>6,743</b>	<b>4,596</b>
<b>Payments</b>			
Payments to suppliers		(1,158)	(1,010)
Payment to employees		(3,856)	(3,803)
Interest paid		(7)	(9)
		<b>(5,021)</b>	<b>(4,822)</b>
<b>Net cash flows from operating activities</b>		<b>1,722</b>	<b>(226)</b>
<b>Cash flows from investing activities</b>			
<b>Receipts</b>			
Sale of property plant and equipment		6	
Investment income		12	34
Interest received		76	84
Distributions from Kiwi Foundation		350	230
Withdrawal of short term investments			
		<b>444</b>	<b>348</b>
<b>Payments</b>			
Purchase of property, plant and equipment		(58)	(16)
Investments in short term deposits		(2,147)	
Purchase of investments			(255)
		<b>(2,205)</b>	<b>(271)</b>
<b>Net cash flows from investing activities</b>		<b>(1,761)</b>	<b>77</b>
<b>Net cash flows from financing activities</b>			
Net increase/(decrease) in cash and cash equivalents		(39)	(149)
Cash and cash equivalents at 1 July		1,729	1,878
Cash and cash equivalents at 30 June	11	1,690	1,729

## KIWILAND CITY MISSION NOTES TO THE FINANCIAL STATEMENTS (EXTRACTS) FOR THE YEAR ENDED 30 JUNE 2015

### NOTE 5. DONATIONS

Donations received during each reporting period are made up of the following:

	Group 2015 \$000	Group 2014 \$000
Donations – street collections	35	33
Donations – general and appeals	2,422	2,061
Donations – services	96	105
Donations – in-kind	2,459	2,393
	<b>5,012</b>	<b>4,592</b>

Donations in-kind include amounts received from major food donors and general food appeals to the public. The value of these donations in-kind is recorded as revenue in the financial statements. The donations received include food distributed to other smaller foodbanks within the Kiwiland Region.

Food donations in-kind are recorded as inventories and are expensed within 'social services' in the Statement of Comprehensive Revenue and Expense as the inventory is consumed in the day-to-day operations of the Mission which includes meals provided at our drop-in centre, food parcels to those in need or for further distribution by other foodbanks within the Kiwiland region.

The Group relies heavily of the generosity of the community within the Kiwiland region both financially and the amount of donated time from volunteers. The Group does not fair value volunteer time in the Statement of Comprehensive Revenue and Expenses as the value of the services provided cannot be reliably measured as there are no equivalent paid positions available in the local labour market, and in the absence of volunteers, the services may not be provided. During the reporting period, total donated volunteers time was 35,547 hours (2014: 34,987 hours).

### NOTE 15. PROPERTY PLANT AND EQUIPMENT

Group 2015	Land	Buildings	Motor Vehicles	Medical Equipment	Office Equipment	Furniture and Fittings	Total
	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Cost	4,545	3,041	320	35	544	319	8,804
Accumulated depreciation		(121)	(275)	(17)	(448)	(266)	(1,127)
<b>Net book value</b>	<b>4,545</b>	<b>2,920</b>	<b>45</b>	<b>18</b>	<b>96</b>	<b>53</b>	<b>7,677</b>

Group 2014	Land	Building	Motor Vehicles	Medical Equipment	Office Equipment	Furniture and Fittings	Total
	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Cost	6,165	4,111	350	28	534	307	11,495
Accumulated depreciation		(82)	(308)	(14)	(425)	(256)	(1,085)
<b>Net book value</b>	<b>6,165</b>	<b>4,029</b>	<b>42</b>	<b>14</b>	<b>109</b>	<b>51</b>	<b>10,410</b>

**KIWILAND CITY MISSION**  
**NOTES TO THE FINANCIAL STATEMENTS (EXTRACTS)**  
**FOR THE YEAR ENDED 30 JUNE 2015**

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**Reconciliation of the carrying amount at the beginning and end of the period:**

Group 2015	Land	Buildings	Motor Vehicles	Medical Equipment	Office Equipment	Furniture and Fittings	Total
	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Opening balance	6,615	4,029	42	14	109	51	10,410
Additions		32	14	11	12	11	80
Disposals			(1)	(2)	(2)		(5)
Reclassifications	(1,620)	(1,080)					(2,700)
Depreciation		(61)	(10)	(5)	(23)	(8)	(107)
		<b>2,920</b>	<b>45</b>	<b>18</b>	<b>96</b>	<b>54</b>	<b>7,678</b>

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