CPA AUSTRALIA

Financial Management and Governance Guide for Not-for-Profit (NFP) Organisations

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Introduction

The not-for-profit (NFP) sector is a vital element of Australia's economy and society more broadly. The NFP sector provides essential services to Australian communities. This would not be possible without the support of the Australian government, volunteers and private philanthropy.

NFPs receive their income in many ways, including through grants, donations, fundraising, events and selling goods. The size of NFPs can range from small groups, such as those focused on sports or religious purposes, through to large service providers in areas such as aged care and health care.

The intention of this guide is to assist with the ongoing (financial) sustainability and good governance of the NFP sector. Given the broad range of NFPs and the various skill levels of those that govern, manage, work within and consult to the sector, this guide aims to be general and non-technical in nature. It is not intended to be a detailed technical manual addressing all matters related to financial management and governance.

The guide does not seek to address management and governance considerations outside financial matters. NFPs are, therefore, encouraged to seek professional advice relevant to their specific situation where required. The guide has been organised with a focus on the most common and challenging topics of financial management and governance as they relate to the NFP sector.

Why is financial management and good governance of NFPs important?

- To help ensure objectives are met.
- Most board/committee members and executive management (office bearers) have a legal duty of care to administer the finances of an organisation in a responsible and diligent manner.[1]
- To ensure statutory/contractual/grant obligations for good financial management and governance are met.
- Communities and governments expect publicly provided funds to be used appropriately.
- To ensure the NFP is financially sustainable.
- To reduce the risk of financial-related errors and fraud.
- To generate accurate and useful financial reports to assist with good decision making.

[1] E.g. Corporations Act 2001 for NFP Public Companies Limited by Guarantee, charities registered with the Australian Charities and Not-for-profits Commission and various state legislation for Incorporated and Unincorporated Associations – refer to CPA Australia's **Charities: A guide to financial reporting and assurance requirements** for more details.

What is a Not-for-Profit (NFP)?

An organisation that is an entity operating for its purpose and not for the profit or gain (either direct or indirect) of individual members[2].

What is a charity?

A type of NFP with charitable purposes that are for public benefit, that doesn't have a disqualifying purpose and is not an individual, political party or government entity. This is based on the legal meaning as per the Charities Act 2013. Not all NFPs are charities, for example a sporting club is a common type of NFP which does not typically fall within the definition of a charity[3].

What is the difference between "financial management" and "governance"?

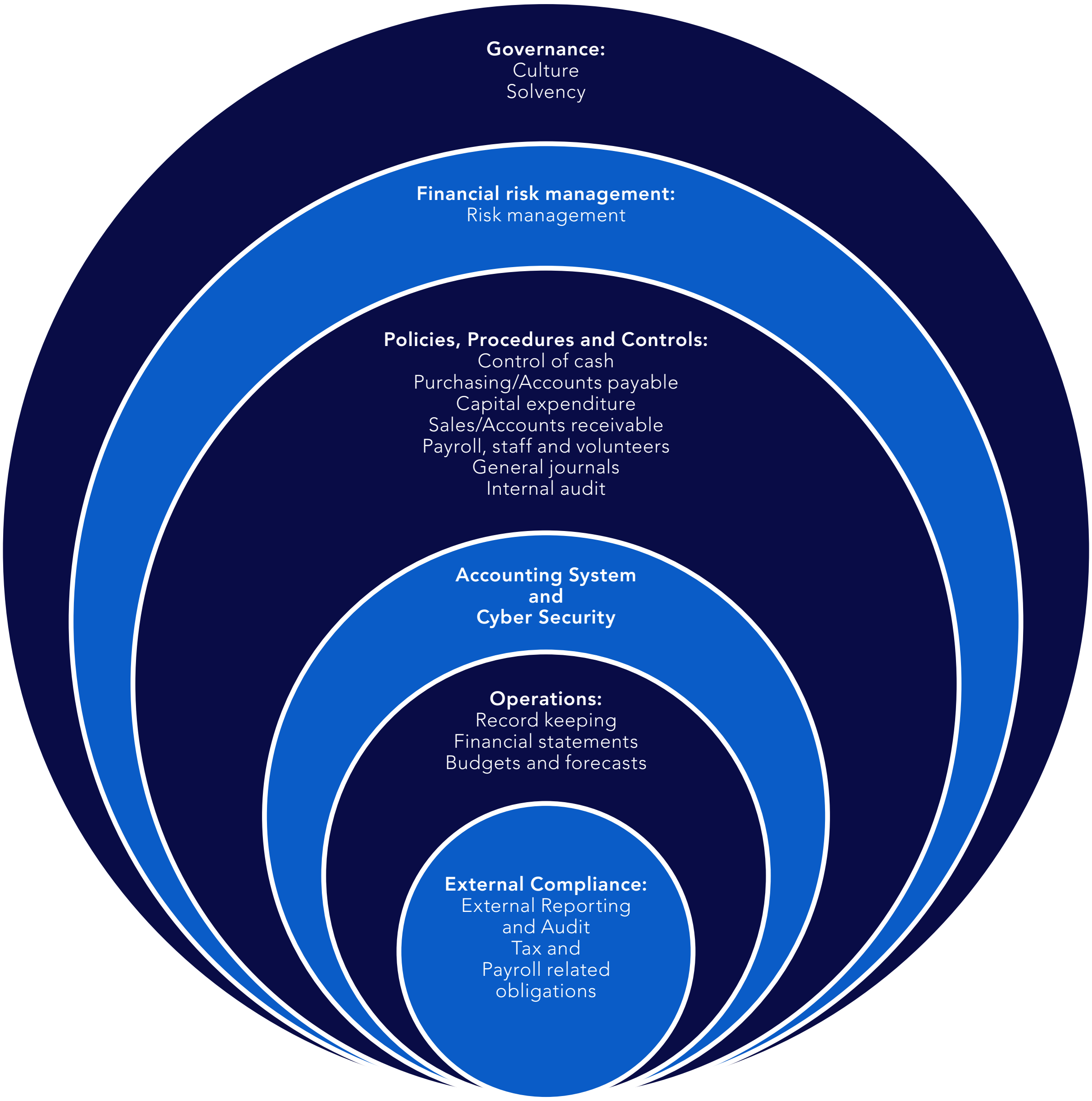
"Financial Management" refers to the staff of an NFP and how they manage financial operations.

"Governance" typically refers to strategic oversight by those individuals (the board/committee) entrusted with ensuring the NFP is fulfilling its objectives. Governance includes oversight of the systems, processes, procedures and controls of an NFP.

[2] As described by the Australian Taxation Office (ATO) - https://www.ato.gov.au/Non-profit/. The Australian Accounting Standards Board (AASB) defines an NFP entity as "an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent and each of the entities it controls".

[3] Refer to Australian Charities and Not-for-profits Commission (ACNC) website for further explanations and definitions - https://www.acnc.gov.au/

The below diagram provides a pictorial depiction of the various key elements of NFP financial management and governance discussed in this guide.



Questions to ask about the financial management and governance of an NFP:

Useful questions that could be asked by anyone getting involved with an NFP to help identify the important aspects of financial management and governance. Note, this is not an exhaustive list.)

- [ ] Is the NFP solvent?
- [ ] Is the NFP financially sustainable?
- [ ] Has the NFP considered other sources of income?
- [ ] Does the NFP have access to professional expertise when required (e.g. an auditor, registered tax agent, CPA NFP adviser, lawyer, financial adviser)?
- [ ] Has the NFP's assets (particularly bank and investment accounts) been verified?
- [ ] How often are bank accounts reconciled and are these up to date? What are the unreconciled transactions, if any?
- [ ] What is the accounting system being used?
- [ ] What type of financial reports are being generated, how often and for whom?
- [ ] Does the NFP have external reporting requirements – e.g. to the Australian Charities and Not-for-profits Commission (ACNC), the Australian Taxation Office (ATO), other government departments, funding bodies or others – and are these obligations up to date?
- [ ] Is an external audit or review of the annual financial statements undertaken each year? If so, were there any qualified opinions or issues raised by the auditor/reviewer that needed resolving?
- [ ] Is an annual or rolling budget approved by the board/committee in place and being reported against? Are these budgets compared against actuals and are any variances explored further?
- [ ] Are financial forecasts being prepared?
- [ ] Is the income, expenditure and use of assets in alignment with the NFP's stated objectives?
- [ ] Do all board/committee members fully understand their financial fiduciary legal duties?
- [ ] Is there a finance or audit sub-committee?
- [ ] Are finance staff/volunteers qualified and/or competent for the finance and accounting work required of them?
- [ ] What financial-related policies, procedures and controls are in place?
- [ ] Are there appropriate delegations (dollar value approval limits) in place?
- [ ] Are all ATO (e.g. GST, PAYGW and FBT) and superannuation lodgements and payments up-to-date?
- [ ] How much of the cash at bank is tied to unspent grants or other obligations?
- [ ] Are staff pay rates and leave entitlements up to date?
- [ ] Are there any other finance-related compliance obligations? If so, what are they and are they up to date (for example, grant acquittals)?
- [ ] How are any conflicts of interest/related party transactions handled?
- [ ] If there are investments being held, is there an investment policy in place?

Governance

Culture, Sustainability and Resilience

The **Culture** of an NFP is a very important consideration for good financial management and governance.

Management and the board/committee must set a good example for staff, volunteers and other stakeholders – i.e. the "tone" from the top is the key. Management/board/committee members must provide clear policies, procedures and forward planning that align to the NFP's objectives. Legal requirements must be followed, obligations to funding providers fulfilled, all staff and volunteers looked after and supported and customers/clients serviced in an appropriate manner.

If a staff member or volunteer is not acting in an appropriate manner in relation to the financial affairs of the organisation, then management and/or the board/committee needs to take appropriate action. This could involve training and education, disciplinary action if required, or in some rare cases, termination of their services.

Communication, both formal and informal should be encouraged between all areas and levels of an NFP. A **whistle-blowing policy** for concerned employees, board/committee members, or other stakeholders is an excellent option to help demonstrate that the NFP is serious about identifying any issues of concern. The ACNC also outlines whistle-blower protections for registered charities, available at **https://www.acnc.gov.au/tools/factsheets/whistleblower-protections**.

Ongoing **financial sustainability** is very important for all NFPs, so they can continue to provide their services to the community. For this reason, there is an expectation and encouragement that an NFP **makes a "profit" or "surplus"**.

Some additional tips to maintain and measure financial sustainability:

- Create and maintain a cash buffer of at least two to three months of average expenditure (refer to the ratios relating to Solvency in Appendix A).
- Create a "Reserve" in the Equity section of the Balance Sheet, backed up by available assets, for future causes (some NFPs will call this a "Future Fund Reserve" or something similar).
- Ensure all new projects or programs are fully considered through a scenario analysis, including running best and worst-case scenarios – i.e. can the NFP afford for an activity, project or program to go wrong?
- Knowing at what point should an NFP pull out or close down a (financially) poorly performing activity or division.
- Create and review longer-term forecasts for three or more years into the future.
- Strategic planning sessions which consider various opportunities and threats to the NFP into the short, medium and long-term future.
- Identify a variety of income streams – i.e. ensure the NFP is not just reliant on one or two streams such as government grants. Other options to generate income streams might include:
  - Creating and promoting a **bequest scheme**
  - Creating and promoting a **regular donation scheme** (for example using an online platform that allows for monthly direct debits and issuing of donation receipts)

- **Sponsorship** options for businesses or individuals (note this may be a particularly useful option for NFPs that do not have Deductible Gift Recipient (DGR) tax status, as sponsorship is typically a valid tax deduction option for a business to provide monies to an NFP, as long as the business name is promoted by the NFP in return for the monies provided)
- **Selling of merchandise**
- **Sub-leasing** excess office space
- Identifying key competencies of the NFP and selling these as **consulting or training services**
- **Investing** available assets using the NFP's investment policy to generate a return.

Financial resilience of an NFP is a vital part of its ability remain financially sustainable. As the COVID19 pandemic proved, an organisation that is flexible, has multiple income streams, has a good workforce looked after through supportive management and that understands its income and expenditure is well-placed to survive and even thrive during challenging times and uncertainty. As we come out of the pandemic, the same NFP characteristics described above should hold true in normal times too.

NFPs should continue to embrace lessons from the COVID-19 pandemic, which include:

- Using online technologies (where appropriate), including consideration of cyber security.
- Adapting to hybrid working (from home and workplace).
- Flexibly managing of resources including labour (staff and volunteers) and materials, particularly when there are shortages.
- Providing structures to support staff and volunteers.
- Developing strong and healthy relationships with clients/customers, suppliers, funding bodies and other stakeholders.
- Put in place disaster recovery and emergency plans
- Relying on key personnel.

[4] Refer to CPA Australia resources on **disaster recovery**.

Solvency

An organisation is **solvent** if it can pay its debts as and when they fall due.

Why is solvency important?

Office bearers have a legal (fiduciary) responsibility to ensure the NFP is solvent and that they make decisions in the best interests of the NFP.

Generally, solvency is considered in the context of the current point-in-time. However, the board/committee should be continually looking forward to ensure solvency can be maintained. While a period of at least 12 months into the future may be considered when determining solvency, there is no limit on the period for consideration.

Solvency is a legal term defined under the Corporations Act 2001 and there is no exact accounting measurement to prove solvency. If there is any indication that the organisation is unable to pay its debts as and when they fall due, and if the board/committee/management is at all unsure of the organisation's solvency, it is important to seek immediate assistance from a suitably qualified advisor (e.g. Licensed Insolvency Practitioner).

There is some correlation between the legally defined Solvency and the accounting concept of "Going Concern" - whether the NFP has the ability to continue to operate into the foreseeable future (usually 12 months after the reporting period end).

This affects the preparation of financial statements and other financial management considerations. An example of an NFP no longer being a Going Concern is where the NFP is in the process of merging with another NFP.

How to determine solvency?

Ensure **financial records are accurate and up to date**:

- Typically, an accurate and up-to-date financial report should be achievable within two to four weeks after the end of a month or quarter with consistent record keeping.
- This must include having bank reconciliations completed up to the date of the report, without any significant unreconciled transactions.
- If using the accrual method of accounting (recommended for all but the smallest of NFPs), ensure the accounting records reflect all supplier invoices and other monies owing. Also ensure that any significant obligations that may give rise to financial liabilities have been agreed since the end of month/quarter. Equally, any amounts receivable from sales (trade debtors) or other funding providers should also be reflected in the accounting records.

Review the **financial reports** and consider such items as:

- Is there enough cash in the bank to cover the debts immediately owing?
- Are there expected cash inflows to cover the cash outflows expected to arise in the coming weeks and months?
- Is the Profit and Loss report showing a surplus (profit) or deficit (loss)?

Analysing the financial health of an organisation

Financial ratio analysis is a common tool employed to analyse the financial health of an organisation and predict the organisation's potential for success or failure and its progress. Ratio analysis enables the identification of trends in the organisation and to compare its performance and condition with the average performance of similar organisations in the same industry.

Although there are many financial ratios that can be used to assess the financial health of an NFP, some of the main ones that can be used easily are listed below. The ratios are grouped together under each area the organisation should focus on for financial survival and prosperity. The formulas relating to each of the ratios listed below are provided in **Appendix A** (all NFPs) and **Appendix B** (NFPs with trading activities).

Ratios	Description
Liquidity ratios	These ratios indicate the ease of turning assets into cash to assess an organisation's ability to pay its bills as they fall due. They include the current ratio, the quick ratio and working capital (which is discussed in detail in the section on working capital management). In general, the higher the ratios in this category, the sounder the organisation's activities and its ability to withstand tight cash flow periods.
Surplus (Profitability) benchmarks	These are ratios that measure an organisation's financial performance.
Operational benchmarks	These are ratios that measure the performance of each distinct activity within the NFP. They enable management to see quickly how successful each activity is.
Management ratios	These monitor how effectively the key cash flow activities of the trading operations are being managed. These measures are referred to as "working capital".
Balance sheet ratios	These ratios indicate how efficiently an organisation is using assets and equity to make a surplus that is utilised in achieving the NFP's objectives.
Solvency ratios	These ratios indicate the extent to which the organisation is able to meet all debt obligations from sources other than cash flow and hence remain solvent and able to continue to operate. Commonly used solvency ratios are leverage, debt to assets and interest coverage ratios.

Financial risk management

Managing risk is an important aspect of NFP financial management but it should be noted that not all risks need to be considered negatively. All NFPs must accept some level of risk to operate successfully. Some NFPs may accept higher levels of risk due to the area they work within or to capitalise on a new opportunity. Some risks have upsides and downsides. For example, undertaking a new program may align better with the NFP's objectives and attract more funding but has new and unknown operational risks.

Some specific items to consider in the context of financial risk management include:

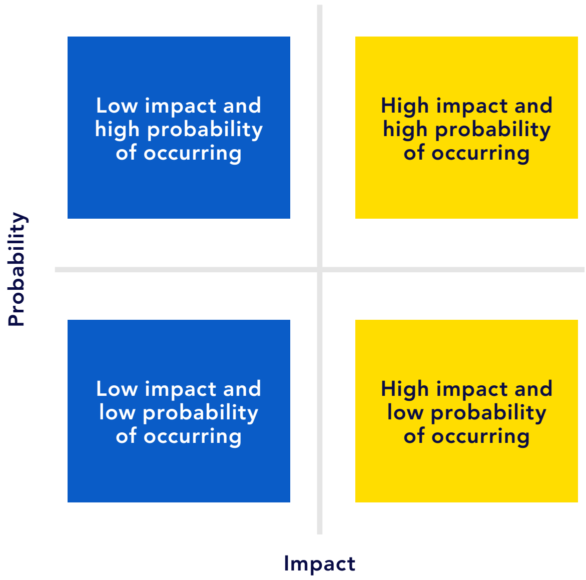
- **Risk appetite** – to be determined by board/committee and management, ideally with a policy documenting the risk appetite, profile of the NFP and overall risk management structure.
- **Risk register**(s) – this could be one register for the whole organisation covering strategic, operational, financial, reputation and other considerations, or broken into various areas.
- New projects, programs or other ventures – how are risks identified, considered at the outset (or as part of **due diligence**) and then managed?

A couple of specific examples of areas of risk management could include:

- **Staff** and **volunteer risk management**, including supporting and encouraging the taking of leave (as this not only can help with healthier workplaces but is also a good test of policies, procedures and controls).
- Reviewing **Insurance policies** is a useful method of identifying and managing some risks. It is recommended to use an insurance broker with NFP experience to assist with this.

Below is a matrix that can be used to help assess the risks within the organisation and prioritise which risks need to be managed. A risk assessment checklist is provided in **Appendix A**.

Risk assessment matrix



Policies, procedures, controls and systems

Why?

To underpin good financial management and governance, it is essential for an NFP to have a system of policies, procedures and controls. This will help an NFP achieve its objectives and ensure appropriate use of monies and other resources, accurate reporting and minimise unwanted risks.

Note: the following relates predominantly to the financial management and governance of an NFP, but there are many other areas that may require policies, procedures and controls. For example, the safety and well-being of staff and volunteers. These other areas are not covered in this guide.

How?

Characteristics of good policies, procedures, controls and systems are:

- Relevant
- Easy to follow
- Documented
- Overseen to ensure adherence
- Reviewed and updated regularly
- Controlled – e.g. use of version numbers, dates of last changes and next review, who can update, security controls and audit trails, if possible
- Principles based – Ideally not too prescriptive.

The initial development of policies, procedures and controls should involve members of the board/committee and management. This will help ensure adherence with the NFP's objectives and ensure the best possible structure that will suit the NFP.

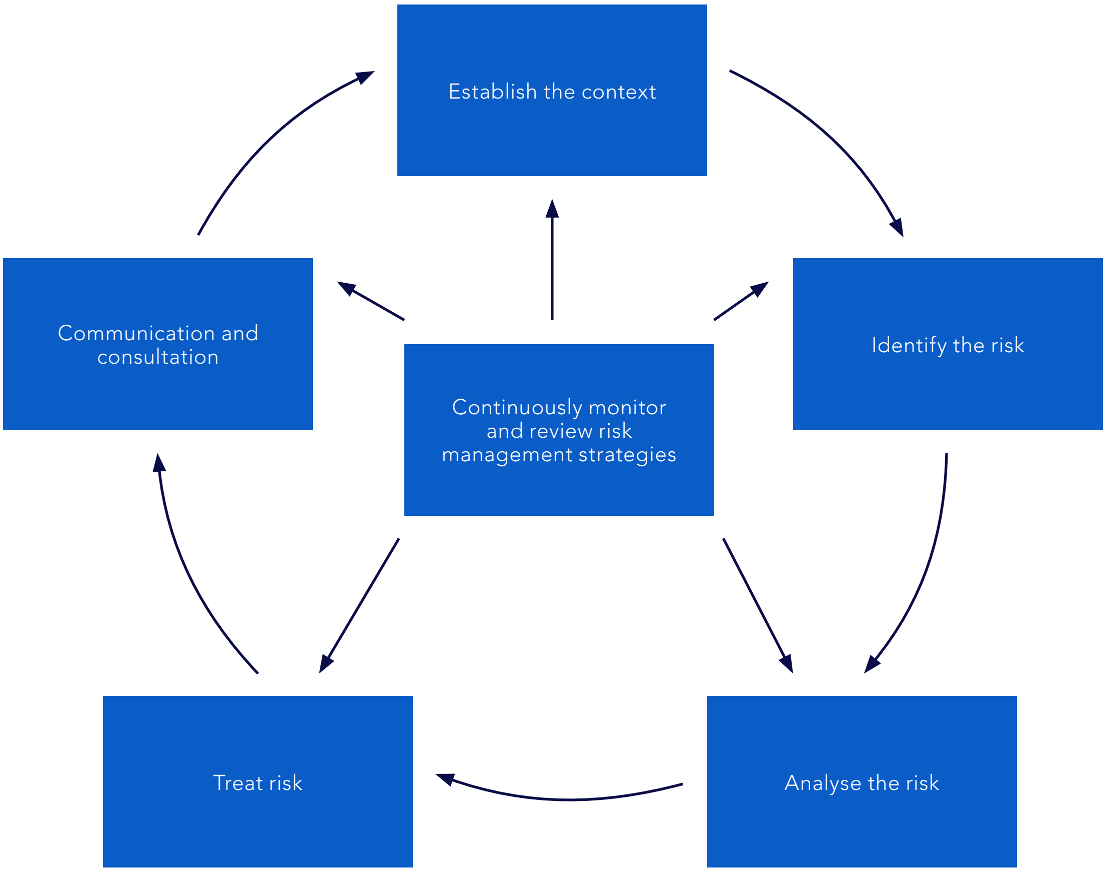
The individual development of each should include the people involved in the area – for example, the accounts payable procedures could be drafted by the accounts payable officer, reviewed by the business manager and approved by the finance sub-committee.

It is recommended that an NFP sets up a register to keep track of all the documented policies and procedures. The register should include details such as the title, description, who is responsible, version control and next review date of each policy and procedure. A register should also help ensure version control and avoid any gaps. The board/committee should have oversight of the register to ensure adequate coverage of all processes and functions and include a review at suitable intervals (usually at least yearly).

Some NFPs may have this area incorporated into their Quality Management System, particularly larger NFPs that hold ISO certification (International Organization for Standardization), RTO (Registered Training Organisation) or other types of certification.

What?

The below diagram provides an overview of some of the considerations when seeking to improve the process for the assessment of internal controls.



Control of Cash

This section is about the control of cash (including physical cash being handled by the NFP and cash in the bank or held in investments). The previous section deals with policies, procedures and controls for overall financial management.

Why?

To avoid:

- fraud
- mismanagement of funds
- mistakes.

How?

Examples of practices that can help with control of cash are provided below:

Delegation limits – typically this is set out in a register showing the monetary limits that apply to various staff and board/committee positions for purchasing and approving payments. There may need to be consideration of exceptions, for example payroll for medium and larger NFPs.

Use of debit/credit cards, petty cash and reimbursements

- **Debit or credit cards** with appropriate delegation limits for total dollar value, as well as dollar value per transaction limits, can be a useful way of empowering staff (and volunteers where appropriate) to get on with day-to-day business. However, some clear guidelines should be provided, including requiring:

  - receipts/invoices be kept for all transactions.

  - reviews of credit/debit card statements by appropriate personnel independent of the card holder.

  - regular reconciliation of each card.

  Credit cards require consideration of the organisation's constitution and related policies, as they can be a form of credit facility.

  Entering of receipts/supplier invoices and reconciliation to the debit/credit card account using the standard bank reconciliation process can make this option quite attractive.

- **Virtual Debit Cards** are a more recent and increasingly used option, similar to a traditional debit/credit card as discussed above. An advantage of a virtual debit card (usually held on a mobile phone as an app) is the centralised and internal ability to add or delete users and easily change delegation limits, as and when required. This is unlike a bank-issued physical debit or credit card where all changes need to be completed via the bank, including time taken in receiving new cards from the bank sent via the mail.

- **Reimbursement** of staff/volunteer/board/committee expenses on a periodic basis can be a useful method to ensure the appropriate documentation is recorded before funds are spent by the NFP. However, given this process is often completed outside of the standard entry of supplier invoices and payment from a bank account (ideally it does follow the same process), it can create processing issues and confusion for those involved. To avoid such issues the expense reimbursement procedure needs to be simple and clearly defined.

- **Petty cash** was previously a common method to help facilitate staff and volunteers making smaller purchases. However, this method has become somewhat out-dated, particularly with the increase in cashless transactions since COVID-19. Petty cash reconciliations can also be notoriously time consuming as the process is separate to a normal bank reconciliation.

Cash collection and banking controls – consideration needs to be given when running fundraising events or donations involving cash. This includes:

- How will the cash be safeguarded?
- Can the cash be received/checked/reconciled/banked by more than one person?
- Are receipts being issued and tallied against cash received?
- Has this process, including the controls in place, been reviewed by an auditor or reviewer and is there any opportunity for improvement?
- Has the external auditor/reviewer raised any concerns with cash collection controls in the audit report or in their communications with the NFP?
- It is noted that many NFPs now use merchant facilities accepting debit and credit cards at events and direct debit forms for receiving donations. This is a useful method to avoid potential issues of handling cash and can improve the reporting of what the monies have been received for. Obviously, very good controls still need to be in place for handling debit/credit card details and ensuring monies are received correctly into the NFP's bank account.

Note: donations may need a separate policy and procedure, given the risks involved of potential misappropriation. This will also ensure donations are received from appropriate sources that align with the NFP's own objectives.

Bank payment authorisations

- Many constitutions dictate that all bank payments need to be authorised by two people.
- Given most NFPs use an online banking option, it is important the authorised people align with delegation limits, suitable authorisers' set-up and that a clear, simple procedure exists for selecting which suppliers to pay. This should include generating an Electronic Funds Transfer (EFT) file from the accounting system (if used), uploading into the online banking platform and approving the payment.
- Bank details for supplier EFTs (typically held within an accounting system) – suitable controls are required around the entry and updating of these details to help ensure accuracy and avoid mistakes or fraud.

Bank reconciliations

- It is vital that bank reconciliations are completed on a regular basis and outstanding transactions followed-up. This may be weekly for organisations with many transactions or otherwise monthly or even quarterly for smaller NFPs. Given cheques and cash are now rarely used there should be minimal, if any, outstanding transactions on a bank reconciliation.
- Verification or oversight of bank reconciliations is recommended to help with the integrity of this important process. For example, the treasurer or equivalent could receive and sign-off a copy of all the operational bank account reconciliations and related bank statement/listings at the end of each period (week, month or quarter). This would help verify they have been completed, cross referenced to the bank statements/listings and ensure any unreconciled transactions are being followed-up.

Bank, merchant and other related services – how to choose?

There are many options for NFPs to choose a financial institution and many other options for merchant and other receivable or credit facilities. Most NFP's constitutions, including the banks themselves, will require approval from the office bearers to open a new account or finance-related service facility. It is worth double-checking how the service or facility will be provided and the costs before going ahead with any particular institution. This could include asking other NFPs about their experiences.

Untied vs Tied funds (can also be referred to as unrestricted vs restricted funds)

- It is important to know and understand how much of the funds in the bank are tied to grants with conditions attached or other contractual arrangements. In most instances, these tied funds are received in advance and the organisation is yet to spend the monies on fulfilling its obligations or other contractual arrangements.
- One method to assist with managing the risk of overspending tied funds is to create a reserve account in the equity section of the balance sheet. This reserve account should be adjusted to equal the unspent tied funds as at the date of the financial reports. For example, these accounts could be called "Unexpended Grant Funds Reserve [name of funding body/program]".

Investment of funds

- It is recommended that an investment policy signed-off by the board/committee is in place, which includes an investment strategy with reference to risk appetite.
- If considering term deposits or other short to medium term investment options, it is worth shopping around for the best interest rates.
- A qualified financial adviser can provide advice in relation to investments and may also be able to assist with determining a suitable investment policy and/or strategy.

Related party transactions/conflicts of interest

- Consideration should be given to transactions with related parties including staff, management and board/committee members.
- Related parties are defined in AASB 124 Related Party Disclosures. In summary they are people or other entities that have control or significant influence over the NFP, including:
  - Board/committee members and senior/key management and their close family members.
  - Other people or organisations that can influence the NFP's decision-making.
  - Subsidiary or joint venture organisations of the NFP.
- A register of related parties and/or transactions is ideal. Certain NFPs may be required to report related party transactions in their financial statements as per Australian Accounting Standards or as required by the regulator (e.g. charities registered with the ACNC).

Purchasing/Accounts Payable

Items to consider for policies/procedures relating to this topic can include:

- Delegation limits (refer to earlier section "Control of Cash").
- Use of purchase orders (preferably system generated).
- Supplier selection process - how and by whom.
- Whether purchases over a certain dollar limit needs to have multiple quotes. For example, purchases over $5000 require three quotes and the mechanism for choosing the successful quote (i.e. cheapest is not necessarily best).
- Whether credit term accounts should be created with certain suppliers and how to ensure these suppliers continue to be used into the future (this can help avoid unnecessary use of petty cash/debit card purchases and ensure purchases are made with a preferred supplier).
- How often are supplier invoices to be paid (fortnightly or monthly can help to provide structure around processes and reduce the amount of administration, as opposed to an ad-hoc payment basis).
- Filing of supplier invoices/expense receipts (source documents). How are these documents filed and linked to a transaction or transactions in the accounting system? Most online systems will allow the source document to be uploaded and attached to the relevant transaction.

Capital expenditure

This can include purchases of equipment (vehicles, property, etc) that has a useful life greater than 12 months and a value greater than a certain materiality threshold (typically a threshold over $1000, although some NFPs have a capitalisation policy of over $100, $500, $5000 and even $10,000 in some cases). The materiality threshold can differ from one organisation to the next. It's very much dependent on the size of the organisation and the risk appetite of the board/ members of the organisation when they are setting the policy on the appropriate capital expenditure threshold.

The larger the organisation, generally the higher the threshold. A policy of larger capital items requiring a business case demonstrating the value to the NFP and how the item will help the NFP achieve its objectives is important.

This should be considered along with an annual capital expenditure budget to guide ongoing asset replacement. As per above, a requirement for capital purchases over a certain dollar threshold may require a certain number of supplier quotes. If capital expenditure is funded by a specific external grant, documentation that links the grant and linked capital expenditure should be kept.

Sales/Accounts Receivable

"Sales" can include consulting fees, sale of goods or other services, sponsorship etc. The policies, procedures and controls documentation should include the below considerations:

- Which staff can approve, produce and send sales invoices?
- What are the standard payment terms (i.e. number of days before the invoice is due for payment)?
- How is payment to be received (EFT, via a third-party merchant facility, or other)?
- How are outstanding invoices monitored and followed-up (e.g. monthly aged receivable reports provided to management with notes about older outstanding balances)? Do debtors with balances overdue require a statement to be sent to them requesting payment? Are they then followed-up by a letter and/or phone call if the amounts remain outstanding after a certain period of time? Is a debt collection agency or some other legal process followed once the outstanding amount is overdue a long period of time, or there is a concern that the customer may not have the financial resources to repay?
- Fundraising receipts may need to be generated from the Sales/Accounts Receivable or online system, particularly for donations. Refer to above section under "Control of Cash" for cash details.

Payroll, staff and volunteers

Many policies, procedures and controls will be required for this important area. Some key areas include:

- Recruitment
- Induction/on-boarding
- Employee/volunteer hand-books/general agreement – typically covers IT/computer/phone/internet usage policy, safe working practices, dispute resolution process and other matters
- Documents required at the start of employment or volunteering:
  - an agreement/contract that links with a job description
  - personal details (e.g. emergency contact details, allergies or other medical conditions, bank details for EFT of wages, etc.)
  - license/registration details, if applicable (such as working with vulnerable people registrations and police checks)
  - In addition, for employees:
    - Tax File Number declaration
    - Super Choice Form
    - Fair Work Information Statement.
- Pay rates (employee – including which Pay Award, if applicable) and allowances (which may be payable to both employees and volunteers)
- Work/volunteer times
- Timesheet entry and approval
- Leave entitlements, application and approval for employees
- Expense reimbursement process (typically covers out-of-pocket travel and other costs, professional development/training costs and use of private vehicles, phones, computers or other equipment). Consider dollar value limits, how the dollar value rates are determined (reference to ATO rates can be useful for this) and pre-approval process.
- Payroll processing – including preparation, approval and payment
- Staff/volunteer review (performance/evaluation) process – typically at the end of a new staff member probation period and then every six or 12 months thereafter
- Consumer rights and data privacy
- Consider what details need to be held on file for staff, volunteers and others (given the increasing number and risk of cyber-attacks and recent cases, it is worth ensuring only necessary information is retained on file or in systems).

Segregation of Duties, Journal Entries and Other Controls

Depending on the number of staff, it is ideal for certain tasks to be segregated. For example, having one staff member reconcile the bank account, while another enters supplier invoices and creates sales invoices. In reality, many NFPs rely on one finance officer to look after all these areas.

Therefore, it is important that payments are authorised by one or two other senior staff and/or board/committee members and that other oversight/review practices are followed. Having an external CPA Australia public practice accounting firm review end-of-quarter accounts and prepare the ATO Business Activity Statements (BAS) can help provide some additional oversight. Staff rotation can also help achieve a similar test on policies, procedures and controls.

Up-to-date, accurate and relevant job descriptions form part of a robust control environment. Ensure staff are fully aware of their responsibilities, that they know where to go for support and that they are competent and capable of what is expected of them. Where there is a need for competencies or capabilities to be enhanced, the NFP should consider training and education of relevant staff.

General Journals

Journal entries to the accounting system should only be done for re-allocations, corrections or end-of-period adjustments. This could be for accruals, movements in provisions, inventory adjustments, allocation of overheads, etc. The individual who has authority to enter journals into the accounting system and whether they need approval should depend on the accounting capability of the finance officer.

It may also be necessary to consider whether those responsible understand the journal they are entering and whether there is a higher-level manager or board/committee member with the expertise to also understand the journal entry and be able to approve entries.

Otherwise, many NFPs may need to rely on the guidance of external advisors including accountants to assist and provide guidance with entering general journal entries. Wherever possible, source documents or calculation workpapers should be attached to Journal entries, particularly for NFPs who require an annual review or audit.

Management of Policies and Procedures

Internal Audit – This function typically only occurs in larger NFPs but is a very useful function to review and assess whether the established policies, procedures and controls are adequate and being followed. An internal audit can also review policies, procedures and controls throughout the year or lead an investigation if there is suspicion of financial errors or fraud. The internal auditors could be either NFP staff who have been trained for the role or be sourced externally (usually from an audit accounting practice). Where an internal audit function exists, the resulting reports would usually be discussed with management and tabled in a Finance and Audit Committee (or similar). It is therefore a very useful function to help board/committee members with their fiduciary duties.

End of month checklist – It can be very useful for the finance officer to go through a process of checking things off for the end of month (or quarter) before producing financial reports. This checklist can also be forwarded to the general manager/CEO and/or treasurer as a governance safeguard mechanism. Typically, this would include reconciliations of most, if not all, balance sheet accounts, bank reconciliations, end-of-period journal entries (if required – such as staff leave provisions, prepaid expenses, etc) and reports that need to be generated.

Some additional checklists are provided below that can be helpful in the management of policies and procedures.

The detailed checklists are included in **Appendix A** and **Appendix B** and can be accessed by clicking on the hyperlinks provided:

- Financial controls checklist
- Financial management governance checklist
- Internal controls checklist
- Checklist for managing stock
- Checklist for managing supplier payments and relationships
- Checklist for managing debtors.

Accounting systems and Cyber security

Accounting systems can incorporate anything from a simple spreadsheet, software program or online application through to large organisation-wide Enterprise Resource Planning (ERP) multifunctional systems. When determining the best accounting system for an NFP, matters to consider should include:

What needs to be recorded, controlled and reported upon, particularly:

- Sales, associated revenue and Accounts Receivable.
- Non-sales income from grants, donations, fundraising and similar activities
- Purchases and Accounts Payable (including whether system-generated Purchase Orders are required).
- Payroll processing and related reporting such as STP (Single Touch Payroll) and auto-superannuation fund lodgements. Caution should be exercised with auto-superannuation fund lodgements for unusual situations, for example, if a staff contract specifies contributions in excess of the minimum superannuation guarantee amount.
- Fixed Assets (for asset management and depreciation).
- Program/department/location/project/funding tracking of income and expenditure (particularly for NFPs with grant income requiring acquittals).
- Budget tracking and reporting.
- GST tracking, reporting and lodgement.
- Financial reporting – for internal management and external end-of-year purposes.

Other considerations include:

- Online (cloud-based), server or PC based systems.
- Integration with other IT systems or applications.
- User authorisation and accessibility for staff, management, board/committee members, auditors and other external accountants or advisers. This should include how easy the system is to use, whether many people have knowledge of the system, availability of training and support, whether the system requires software to be loaded on each user's PC and whether access is available across multiple IT platforms (such as smart phones, tablets, Mac and PC).
- Audit trail - i.e. system tracking of system user logins and entries of, or changes to, information or set-up.
- Ability to upload bank statement information and automatically enter/reconcile certain transactions based on recurrence and/or rules.
- Ability to track non-financial information (for example for Environmental, Social and Governance (ESG) purposes).
- What, if any, personal details need to be held in the system for staff, volunteers, clients and other contacts (privacy laws need to be considered).
- Investment costs (one-off or periodic subscription).

The structure of the General Ledger Chart of Accounts needs to be appropriate for the NFP, based on information requirements of management, board/committee and external parties. One useful approach is to base the Chart of Accounts on the ACNC National Standard Chart of Accounts (regardless of whether the NFP is a registered charity or not) and having a separate list of program/department/location /project/funding categories (some systems will call these categories job codes, cost/profit centres, divisions or tracking categories).

Refer to **www.acnc.gov.au/for-charities/manage-your-charity/national-standard-chart-accounts**

Cyber security

(Data storage, particularly relating to the accounting, payroll and customer/supplier systems.)

Given the increasing risks and cases of cyber attacks, it is important to consider the following questions in relation to financial management systems:

- Where is the data being stored – PC, server, online (cloud) or a combination? Is data stored overseas and, if so, is this in compliance with any legal requirements or internal policies?
- If third-party software vendors are used, do the vendors provide integrated cyber security? Are cyber security measures frequently updated? Is the vendor liable for damages caused by cyber attacks?
- What are the security features for the data storage – e.g. up-to-date strong firewalls for a server, up-to-date software, separate individual logins for each user with multi-factor authentication or similar?
- Are all users of the system aware of how to avoid cyber attacks, e.g. from phishing emails?
- What is the procedure if a cyber breach does occur?
- Has the IT system's security been checked by a specialist?

Refer to **https://www.cpaaustralia.com.au/tools-and-resources/cyber-security**

Operations

Proper record keeping

Why?

Internal purposes – so that management and board/committee members have information to ensure the NFP is on track to achieve its objectives and remain solvent.

External purposes – for fulfilling statutory obligations, grant acquittals, constitutional or contractual reasons. For example, registered charities must report to the ACNC and many grant recipients need to report back to the providers of the funds on how they have applied the funds.

Financial records must be:

- accurate
- timely
- useful/relevant
- compliant (particularly for external reporting purposes).

How can this be achieved?

Accuracy:

- Policies and procedures that are reviewed regularly and followed by everyone.
- Regular bank and other account reconciliations with oversight.
- Allocation of transactions at the source by the person responsible for the transaction is becoming more common with bookkeeping apps. This situation requires those people to have an understanding of the NFP's account structure, along with an approval, oversight and/or review process. Audit or other assurance of annual financial reports may help provide credibility over information included in the reports. The audit or other assurance requirement may be dependent on the requirements of ACNC, other government departments, funding bodies and members/board/committee.

Timeliness:

Reports are generally considered to be timely if they are prepared and provided as below:

- End-of-month - within two to three weeks.
- Quarterly – within three to four weeks.
- Annual – within two to three months for internal or external purposes (statutory deadlines may also be relevant, for example, four months for companies limited by guarantee with ASIC and six months for charities registered with the ACNC). It should be noted that any audit or other assurance will also need to be conducted within the time period.
- Ad-hoc – if required under contract or other grant agreement (for example by an external grant provider).

Usefulness/relevance/compliance:

- Chart of accounts – for example, using the ACNC and government-endorsed Standard Chart of Accounts for the Charity sector[5].
- Sector appropriate (e.g. residential aged care has some particularly complex industry-specific reporting requirements and industry-accepted ways of allocating income and expenses).
- Adherence to Australian Accounting Standards Board (AASB) accounting standards[6], where applicable or required. Note there are some AASB accounting standards that have particular relevance to the NFP sector (e.g. AASB 1058 Income of Not-for-Profit Entities).

Financial statements

Which reports to use (and what do they mean)?

The following are the most commonly used types of reports (statements) for both internal and external purposes. However, please note that governments, grant funders, members and/or other NFP rules may require different reports/statements.

Profit and Loss (can also be known as "Statement of Income" or "Statement of Income and Expenses").

A statement showing the income and expenses of the NFP over a specified period of time (typically a month, quarter or year), which totals to a net profit (surplus) or loss (deficit).

These can be reported on a "cash" or "accrual" method:

- **"Cash" basis** – as the income is received and expenses paid, or
- **"Accrual" basis** – as the income is earned and expenses incurred (i.e. typically based on when a sales invoice is created for a customer/client and invoice/goods/service received from a supplier). Some NFPs may have a mandatory requirement to produce reports using the accrual basis. The accrual method is considered a more accurate method of accounting.

If the Accrual basis of reporting is being used, then the Profit/Loss or Surplus/Deficit will be different to the net cash inflow or outflow for the year due to accrual-based accounting entries.

Income/Sales/Revenue – These account headings are generally used for monies or goods received by the NFP on a gift basis and/or in return for goods or services provided by the NFP.

The accounting treatment is set out in AASB 15 Revenue from Contracts with Customers and/or AASB 1058 Income of Not-for-profit Entities. Examples of accounting transactions can include:

- Revenue from sale of goods/products or services
- Grant income other than revenue described above
- Donations/bequests
- Interest earned from bank balances or investments
- Investment earnings (e.g. dividends).

[5] https://www.acnc.gov.au/for-charities/manage-your-charity/national-standard-chart-accounts

[6] https://aasb.gov.au/

Cost of Goods Sold – expenses directly related to Sales Revenue. For example, the cost of food and drink for re-sale at a sports club canteen.

Expenses – costs incurred in earning income and running the operations of the NFP, which are not directly related to the generation of revenue.

Examples include:

- Wages, salaries and other employee-related expenses
- Program-related costs (typically fall under "Client Support Services")
- Advertising, marketing and fundraising costs
- Rent
- Finance costs
- Insurance
- Professional fees for legal, accounting, audit and other advisory services
- Depreciation/amortisation
- Meeting and board expenses
- Travel and accommodation
- Utilities (electricity, gas and water).

An example of a profit and loss statement prepared under the accrual basis is provided below:

Profit and Loss Statement Example (accrual basis)

For the year ended 30 June [YYYY]

	Current Year	Prior Year
Income	($)	($)
Grants - State Government Recurrent	150,000	125,000
Grants - State Government Non-Recurrent	50,000	-
Grants - Federal Government Non-Recurrent	100,000	75,000
Donations and Bequests	25,000	20,000
Sponsorships	15,000	12,000
Sales of Merchandise	20,000	18,000
Consulting and Service Fee Income	75,000	70,000
Interest and Other Investment Income	2,000	1,800
Other Income	5,000	4,000
Total Gross Income	**442,000**	**325,800**
Less Cost of Goods Sold (if applicable)*	**(5,000)**	**(4,000)**
Net Income	**437,000**	**321,800**

Expenses	($)	($)
Accounting, Audit and Bookkeeping Fees	5,500	5,000
Advertising and Promotion	1,200	1,100
Bank and Merchant Fees	1,150	1,085
Board/Committee/Governance	850	825
Client Support Expenses (Programs and Events)	34,477	34,375
Computer and IT	1,850	1,625
Consulting Fees	2,500	3,250
Depreciation - Office Equipment and Vehicles	11,206	12,625
Depreciation and Amortisation - ROU Assets***	12,600	12,600
Fundraising Expenses	3,250	3,050
Insurance	5,500	5,250
Meeting Expenses	850	825
Membership (Affiliation) Fees	750	725
Motor Vehicle Expenses	6,750	6,500
Office Expenses (including minor equipment under $1,000)	6,500	7,850
Postage, Freight and Courier	950	925
Printing and Stationery	2,250	2,100
Rent Expense***	16,500	16,100
Repairs and Maintenance	825	2,250
Staffing (inc Salary and Wages, Super, Leave)	279,000	187,500
Telephone and Internet	11,500	10,950
Training and Development (Staff)	7,800	6,000
Utilities (Electricity, Gas, Water)	3,300	3,150
Travel and Accommodation	1,650	1,850
Volunteer Costs	2,300	2,400
Total Expenses	**421,008**	**329,910**
Net Surplus/(Deficit)**	**15,992**	**(8,110)**

* Cost of Goods Sold is typically only used if there are direct costs relating to the Sales Income, for example purchase of food and drink for an event.

** Net Surplus/(Deficit) could also be called Profit/(Loss).

*** Typically there would be either Rent Expense or Depreciation/Amortisation for Right of Use (ROU), rather than both, depending on how the accounting standard AASB 16 Leases has been applied.

Balance Sheet (also known as **"Statement of Financial Position"**)

A statement at a point in time (typically at the end of a month, quarter or year) that includes the NFP's **Assets**, **Liabilities** and **Equity** (equity also known and sometimes labelled as "Accumulated Funds" or "Members Equity").

It is the financial status, or effectively the net worth of the NFP, at the date of the statement. Total assets less total liabilities equals total equity – therefore it must balance, as the name suggests!

Assets are items that have the potential to generate future economic value to the NFP - i.e. resources that can be used into the future to help the NFP carry out its operations. They fall under two categories:

- **Current Assets** include items which are generally realisable within a 12 month period – such as cash at bank, accounts receivable (monies owed by customers), inventory/stock and prepaid expenses.
- **Non-Current Assets** include items that are generally realisable beyond 12 months. Examples include:
  - **'Fixed Assets'** or Property, Plant and Equipment (physical items) – such as land and buildings, office furniture, motor vehicles, computer equipment and leasehold improvements.
  - **Intangible Assets** (non-physical items) – such as licenses and copyrights.
  - **Financial Assets** and Other Assets – such as long-term investments.

Liabilities are owed by the NFP to other parties, typically in the form of money.

- **Current Liabilities** – amounts owed within the next 12 months, such as accounts payable (monies owed to suppliers), accrued expenses, provisions for staff annual and current long service leave, ATO-related debt (GST, PAYGW, FBT) and provision for superannuation.
- **Non-Current Liabilities** – amounts owed beyond 12 months, such as provisions for long service leave for staff not owed within the next 12 months, and loans.

Equity/Accumulated Funds – are equal to total assets less total liabilities. It is therefore the net financial position of the NFP as at the reporting date. Equity is made up of:

- Retained Earnings – i.e. the net total of all prior and current period surpluses (profits) and deficits (losses)
- Reserves - created from asset revaluations, or accounting transfers from Retained Earnings
- Contributions from members.

An example of a balance sheet is provided below:

Balance Sheet

As at 30 June [YYYY]

	Current Year	Prior Year
Assets	($)	($)
Current Assets		
Cash at Bank	84,529	20,346
Accounts Receivable	12,500	15,500
Inventory	9,500	8,500
Prepaid Expenses	2,750	1,050
Total Current Assets	**109,279**	**45,396**
Non-Current Assets		
Office Equipment	12,000	11,000
Less Accumulated Depreciation on Office Equipment	(8,800)	(6,500)
Motor Vehicles	85,000	45,000
Less Accumulated Depreciation on Motor Vehicles	(18,281)	(9,375)
Right of Use Asset (Office Lease)	63,000	63,000
Less Accumulated Depreciation on ROU Asset	(25,200)	(12,600)
Long-Term Investments	20,000	20,000
Total Non-Current Assets	**127,719**	**110,525**
Total Assets	**236,998**	**155,921**

Liabilities	($)	($)
Current Liabilities		
Accounts Payable	19,350	5,645
Accrued Expenses	935	1,240
ATO - GST and PAYGW Liabilities	10,555	8,250
Superannuation Payable	1,953	1,250
Annual Leave Provision Current	15,023	10,096
Long Service Leave Provision Current	8,500	-
Loan Motor Vehicle - Current	10,000	-
Lease Liability Current	12,000	12,000
Unexpended Grant Funds*	10,000	-
Total Current Liabilities	**88,316**	**38,481**
Non-current Liabilities		
Long Service Leave Provision Non-Current	2,500	7,250
Loan Motor Vehicle - Non-Current	30,000	-
Lease Liability Non-Current	38,000	48,000
Total Non-current Liabilities	**70,500**	**55,250**
Total Liabilities	**158,816**	**93,731**
Net Assets	**78,182**	**62,190**

Equity	($)	($)
Current Year Earnings	15,992	(8,110)
Retained (Prior Year) Earnings	52,190	65,300
Reserves (Revalued Assets/Unexpended Grants**)	10,000	5,000
Total Equity	**78,182**	**62,190**

* Unexpended Grant Fund Liability is typically only for Capital Works (Asset purchase) Grants, as per AASB 1058.

** Unexpended Grant Reserve is typically only used if there are Unspent Grant funds that have already been brought to account in the Profit and Loss as per AASB 1058

Note: many NFPs will not have all the above account categories – these will vary depending on the operations of the NFP, reporting requirements and how the AASB accounting standards have been applied.

Advanced Tips:

A Reserve for Unexpended Grant Funds can be a useful account for tracking unspent grant funds that have already been recognised as revenue (income) in the Profit and Loss.

This practice can be particularly useful when funds are earmarked either internally by the board/committee or externally by the funding provider for specified purposes.

Financial Year End – many NFPs have a different year-end to for-profit businesses. For example, sporting clubs can often have a year-end of 31 March, while arts-based NFPs can often have a year-end of 31 December.

It is important to bear in mind that for ATO purposes payroll end-of-year remains 30 June and the FBT year-end remains 31 March, regardless of the NFP year-end.

An example of a cashflow statement is provided below:

Cash flow statement (or statement of cash flows)

- This is a statement showing the cash inflows and outflows over a specific period of time.
- This statement is typically prepared at year-end for most NFPs (depending on internal and external) reporting requirements and some NFPs may choose to also report at periodic intervals throughout the year.

Statement of Cash Flows (Direct Method Example)

For the year ended 30 June [YYYY]

	Current Year ($)	Prior Year ($)
Operating Activities		
Receipts from Grants	310,000	200,000
Receipts from other operating activities	143,000	124,000
Payments for other operating activities	(389,817)	(308,685)
Net Cash Flows from Operating Activities	**63,183**	**15,315**
Investing Activities		
Proceeds from sale of property, plant and equipment	-	5,000
Proceeds from Investments	2,000	1,800
Payment for property, plant and equipment	(41,000)	(2,500)
Net Cash Flows from Investing Activities	**(39,000)**	**4,300**
Financing Activities		
Proceeds from financing activities	40,000	-
Net Cash Flows from Financing Activities	**40,000**	**-**
Cash and Cash Equivalents		
Cash and cash equivalents at beginning of period	20,346	731
Net change in cash for period	64,183	19,615
Cash and cash equivalents at end of period	**84,529**	**20,346**

Program reporting

Program reporting refers to reporting on the income and expenditure for each program, event, cost/profit centre or division. This can be particularly important to help manage the organisation's objectives and the allocation of spending to the appropriate programs. Program reporting can also be useful, or even necessary, when external funders provide funding through grants or other means for a specific purpose or purposes. For example, where there are multiple grants or other funding sources that need to be reported against, other divisions based on geographic or service-related focuses, or other reasons for which program reporting may be considered useful. Program reporting can be included in statutory (end of year) financial statements as note disclosures.

Consideration should be given to apportioning overhead (administrative/corporate) costs on a pro-rata or other reasonable basis. For example, this could be calculated as a percentage of revenue earned for each program – as shown in the following example for Depreciation, Insurance, Rent and Telephone costs. Training and Development in the example below has been apportioned based on Wages and Salary costs for each Segment. It should be noted that this is just one example of how apportionment of overheads could be achieved and does not exclude other reasonable means of such apportionment.

Profit and Loss Example by Program

For the (Current) year ended 30 June [YYYY]

	Program 1	Program 2	Program 3	Event XYZ	Admin	Total
Income	($)	($)	($)	($)	($)	($)
Grants - State Gov Recurrent	150,000	-	-	-	-	150,000
Grants - State Gov Non-Recurrent	-	50,000	-	-	-	50,000
Grants - Federal Gov Non-Recurrent	-	-	100,000	-	-	100,000
Donations and Bequests	-	5,000	-	-	20,000	25,000
Sponsorships	-	-	-	10,000	5,000	15,000
Sales of Merchandise	-	-	-	18,000	2,000	20,000
Consulting & Service Fee Income	-	-	-	-	75,000	75,000
Interest and Other Investment Income	-	-	-	-	2,000	2,000
Other Income	-	-	1,000	2,500	1,500	5,000
Total Gross Income	**150,000**	**55,000**	**101,000**	**30,500**	**105,500**	**442,000**
Less Cost of Goods Sold (if applicable)	**-**	**-**	**-**	**(5,000)**	**-**	**(5,000)**
Net Income	**150,000**	**55,000**	**101,000**	**25,500**	**105,500**	**437,000**

Expenses	($)	($)	($)	($)	($)	($)
Accounting, Audit and Bookkeeping Fees	-	-	-	-	5,500	5,500
Advertising and Promotion	-	-	-	1,000	200	1,200
Bank and Merchant Fees	-	-	-	-	1,150	1,150
Board/Committee/Governance	-	-	-	-	850	850
Client Support Expenses (Programs and Events)	25,000	2,000	7,500	3,000	3,023	34,477
Computer and IT	-	-	-	325	1,525	1,850
Consulting Fees	-	-	-	-	2,500	2,500
Depreciation - Office Equipment and Vehicles	3,803	1,394	2,561	773	2,675	11,206
Depreciation and Amortisation - ROU Assets	-	-	-	-	12,600	12,600
Fundraising Expenses	-	-	-	500	2,750	3,250
Insurance	1,867	684	1,257	380	1,313	5,500
Meeting Expenses	-	-	-	-	850	850
Membership (Affiliation) Fees	-	-	-	-	750	750
Motor Vehicle Expenses	2,500	-	-	1,350	2,900	6,750
Office Expenses (including minor equipment under $1,000)	5,000	-	-	-	1,500	6,500
Postage, Freight and Courier	-	-	-	-	950	950
Printing and Stationery	-	-	-	-	2,250	2,250
Rent Expense	5,600	2,053	3,770	1,139	3,938	16,500
Repairs and Maintenance	-	-	-	205	620	825
Staffing (inc Salary and Wages, Super, Leave)	89,500	44,250	86,225	17,750	41,275	279,000
Telephone and Internet	3,903	1,431	2,628	794	2,745	11,500
Training and Development (Staff)	2,502	1,237	2,411	496	1,154	7,800
Utilities (Electricity, Gas, Water)	1,120	411	754	228	788	3,300
Travel and Accommodation	250	-	-	950	450	1,650
Volunteer Costs	1,275	-	400	625	-	2,300
Total Expenses	**142,319**	**53,461**	**107,505**	**29,514**	**88,209**	**421,008**
Net Surplus/(Deficit)	**7,681**	**1,539**	**(6,505)**	**(4,014)**	**17,291**	**15,992**

Budgeting/Forecasting

Budgets and Forecasts are very useful financial management techniques to plan and monitor future income and expenditure. They are the tools that develop the strategic plans of the organisation into financial outcomes. These financial outcomes enable boards and management committees to evaluate and monitor the plans. Most NFPs operate without large reserves to draw on. Therefore, budgeting and forecasting will provide the financial information to enable management to decide if the strategic plans will support the ongoing operations. Points to consider include:

Ensuring income and expenditure **aligns with the NFP's objectives**. (Some NFPs will have a strategic plan that also guides the development of a budget.)

Ideally having the **responsible staff/managers** involved taking responsibility for the budgets in their respective areas.

- **Regular reporting** against budget – e.g. monthly for staff and management and quarterly for board/committee (or this may be the same period for both management and board/committee).
- Consideration of **reliance on volunteers and other pro-bono resources** – what would happen if these resources had to be paid for?
- Documenting all **assumptions** made for determining the expected income and expenses. This will be useful for board/committee to review when approving the budget or for reflection and review when reporting the actual income and expenses against budget (variance analysis). For example, assumptions that grant income will increase by 2.5 per cent based on the Consumer Price Index (CPI) as per the Grant Deeds, staff wages will increase by 3 per cent based on wage agreements, other expenses will increase by 2.5 per cent based on CPI can be reviewed when actual figures are available. Note: while reference to the previous period income and expenditure is typically useful for creating a budget or forecast, it is important to review and ensure historical figures are relevant for the future.

Budget versus forecast - Budgeting is the process of planning the finances over the budget period. Budgeting can also provide an opportunity to plan ahead for several years in an effort to identify changing conditions that may impact on the organisation's operations and cause financial difficulty.

Meanwhile, forecasting can be used to review actual and anticipated income and expenses against budget. Forecasting provides the financial information that shows if plans need to be amended, whether grant-funded programs/activities are on-track and enables the organisation to be proactive in achieving its goals.

A **Capital Expenditure** budget for the coming 12 months is also important. As a rule of thumb, this could be based on depreciation (i.e. assuming relatively realistic depreciation rates are being used on all assets). If the annual capital expenditure budget is greater than annual depreciation, this would suggest that the asset base is growing, prices have increased or an asset renewal program is being undertaken.

In contrast, if the annual capital expenditure budget is less than annual depreciation, this would suggest that assets are being run down and not replaced (which could result in a much larger amount needing to be spent in future).

Good budgeting and forecasting require the following:

- Preparation against strategic goals set and approved by the board or management committee.
- Budgeted timelines aligned to the preparation of financial statements.
- Regular comparison of budgets against actual financial results as disclosed in the financial statements.
- Scope for amending activities and targets where actual results indicate that budgeted outcomes will not be met.

In short, for NFPs, budgets and forecasts provide information on the future of the organisation. If planned and managed well, they will be the central financial statements that allow the board and management to monitor the financial impact of the organisation's strategic plans.

Income and expenditure budget

An income and expenditure budget is an important tool for NFPs because activities that generate profit enable the organisation to be less reliant on external funding. This budget is a summary of expected income and expenses set against the board-approved activities for the budget period. This period is usually for one year, although in some cases the period can be shorter or longer depending on the direction set by the board or management committee.

For example, if the NFP has a specific approved program that requires to be funded over a two-year period, then the budget will need to be formulated over this timeframe. In some instances, NFPs that have a variety of discrete activities with distinct income and expense items for each activity (or program) will require a budget for each of these activities.

The board or management committee should outline the key activities for the organisation. Then it is the responsibility of management to prepare the budget.

An accountant can be of assistance in this preparation but it is important that management and staff be involved in the process. The income and expenditure budget will be used as a key management tool to drive operations of the organisation to achieve the required financial outcomes.

When setting strategic goals for the budget process, the board/committee should be aware that the approved budget will provide direction to management on the operations of the organisation.

Therefore, the budget becomes a governance tool that the board will use to monitor the overall management of the organisation.

Preparing the income and expenditure budget

The key to successful preparation of an income and expenditure budget is to do it in an orderly manner, involving all key staff and ensuring that the goals of the organisation are clearly understood from the outset. There are two methods:

- Incremental: where previous years' activities are used as the basis for preparation.
- Zero-based: where all the financials are prepared without consideration of past activities.

For annual budgeting, the preferred method would be incremental, as zero-based would require an enormous amount of resources and time to prepare. In the case of project or activity-based budgets then zero-based may be more suitable, particularly for new programs where there is no previous history of financial data.

An annual budget preparation policy should be documented and followed. It could include some or all of the following steps:

1. Review the approved strategic plan and note all required activities for the budget year.
2. Separate the activities into existing and new.
3. Document all assumptions that will be made from the approved strategic plan.
4. Review the previous year's income and expenditure statements by agreed period (monthly, quarterly.).
5. Separate income and expenses by activity or program.
6. Determine the income and expense for each program and work out the changes required for each.
7. Combine all income and expenses into one statement and review the financial outcome (profit or loss?).
8. Discuss any amendments required. For example, if a program is running at a loss, the NFP may decide to drop it or else allow other profitable programs to fund the loss.
9. Present the income and expenditure budget to the board or management committee for approval.

Monitoring and managing the income and expenditure budget

There are a number of ways that the income and expenditure budget can be managed. As noted at the beginning of this section, it is important that regular financial statements – in particular, income and expenditure statements – be prepared so that the actual activities can be compared to the budgeted activities.

Standard practice would be to prepare monthly statements. However, the board or management committee may agree to quarterly preparation for smaller NFPs. Remember, the more frequent the reports, the better operations can be reviewed for financial impact and action can be taken quickly where required.

Where the income and expenditure statements are prepared monthly, the budget will need to be separated into months for the budget period. Where the NFP is also preparing segment reports, each segment budget should also be separated into months. At the end of each month, the actual results are compared to the budgeted results and any variances noted and analysed.

All variances should be noted on the reports presented to the board or management committee and explanations provided. Variances should be categorised as either timing or permanent. A timing variance is where the estimated result did not occur but is still expected to occur. A permanent variance is where the expected event is not likely to occur at all.

The beauty of this analysis is that each variance can be considered. Action can be taken to counteract future variances or to implement new or improved activities to ensure the strategic goals underlying the budget can still be achieved.

Forecasting

A forecast is essentially a budget that has been amended to reflect actual events as they occur. See the "Budget vs forecast" section above for an explanation of the difference between the two. The two forecasts used by most organisations are the income and expenditure forecast and the cash flow forecast. Where variances are highlighted in the budget analysis and management make decisions to amend certain activities, the amendments need to be reflected in a forecast.

While forecasting can be a valuable exercise, smaller NFPs that undertake budgeting may not need to undertake the preparation of forecasts in great detail (as discussed below). Forecasting can also have different ramifications to NFPs compared to the for-profit sector. Forecasting by NFPs may be needed to plan ahead to ensure provisions are made for grant monies received to be spent in a timely and appropriate way as intended in the grant agreement. In the for-profit sector, forecasting is often used to ensure there are sufficient cash inflows to cover cash outflows. In contrast many NFPs that rely on grant income will already have cash in the bank. Forecasting will be useful in tracking the expenditure of grant monies received to ensure grants are acquitted in accordance with agreements.

Income and expenditure forecasting

The income and expenditure forecast will be developed once variations to the budget have been identified, usually at the end of the month. For both permanent and timing differences, adjustments to the financial information will be required.

Before undertaking any amendments, it must be ascertained if the end result (i.e. the surplus/profit target) has changed. If the answer is no, then amendments can only be made within the months reported. However, the final result will remain. If management or the board decide that the changing conditions mean the end result needs to be adjusted a new budget should be developed and approved based on this decision.

The key to successful income and expenditure forecasting is to regularly review results, identify variances and implement strategies early to ensure that the approved budget will be met.

Cash flow forecasting

A cash flow forecast is an important tool for NFPs with limited cash reserves, heavy reliance on contributed funds and possible restrictions to accessing external finance. A cash flow forecast will predict an organisation's ability to maintain the cash necessary to support its operations. It will also indicate any cash flow gaps that may be experienced (periods when cash outflows exceed cash inflows).

A cash flow forecast can be developed from the existing information that already exists in the organisation. After 12 months the organisation will have a good idea on what the cash balance will be month by month for the following year of operations.

There are a few ways to use a cash flow forecast as a planning tool:

- Short-term planning to see where more cash than usual is needed. For example, in a month when several large annual bills are due and there is not likely to be much cash in the bank.
- Organisational planning (long-term planning) to ensure that the NFP maintains adequate cash reserves to support its long-term strategic goals.

A cash flow forecast differs from an income and expenditure forecast in that it gives the timing of payments and receipts, including the payment of liabilities and asset purchases. It is the difference between profit and cash that makes it necessary to prepare a cash flow forecast in addition to an income and expenditure forecast.

The easiest way to prepare a cash flow forecast is to break up the income and expenditure forecast into shorter timeframes and then bring all the information together at the end.

The five steps to preparing a cash flow forecast are:

1. Prepare a list of assumptions.
2. Forecast receipts (i.e. list all the grants, donations, fundraising activity income and other funds that are expected to be received).
3. Detail any other estimated cash inflows (including asset purchases).
4. Detail all estimated cash outflows (including payment of liabilities).
5. Assemble all the gathered detail to create the cash flow forecast.

The key to preparing an accurate cash flow forecast is to accurately estimate the timings of receipts and payments.

Finalising the cash flow forecast

The time period for the forecast will have been set at the start of collecting the information for the cash flow forecast. Remember that cash flows are all about timing and the flow of cash, so an opening bank balance will be required. Then add in all the cash inflows and deduct the cash outflows for each period, usually by month.

The number at the end of each month is referred to as the "closing" cash balance and this number becomes the opening cash balance for the next month.

Once finalised, a cash flow forecast will provide the closing cash balance for each month. When compared to an income and expenditure forecast the balances at the end of each month will be different as the cash flow forecast will include cash items that do not a ppear in the income and expenditure statement. For example, the purchase of assets will appear in the cash flow forecast.

However, this is not included in the income and expenditure statement (it is entered into the balance sheet). Therefore, the cash flow forecast will enable managers, the management committee and/or board to see how much cash is available. This is extremely important for all organisations.

External compliance

External reporting requirements

All active NFPs should be preparing end-of-year financial statements for statutory or other external reporting purposes and/or for internal financial management and good governance. External reporting of annual financial statements is often required by one or more government departments, funding bodies (providers of grants), members or others, including:

- **Australian Charities and Not-for-profits Commission (ACNC)**
  - Medium and large charities are required to prepare and lodge financial reports (Special or General-purpose financial reports depending on whether the charity determines itself to be a reporting entity or not). An audit is required for the financial report of a large charity while a medium sized charity can have the financial report reviewed. Small charities are not required to prepare and lodge financial reports, but some financial information must be provided as part of the Annual Information Statement.
  - Annual Information Statement – All charities are required to lodge an Annual Information Statement that includes operational and financial information.
  - For further information, refer to the ACNC website.
- **Public companies limited by guarantee**
  - Medium and large companies limited by guarantee (that are not charities registered with the ACNC) are required to prepare and lodge financial reports (Special or General-purpose financial reports, depending on whether the NFP determines itself to be a reporting entity or not) with the Australian Securities and Investments Commission (ASIC). An audit is required for the financial report of a large company limited by guarantee while a medium sized company limited by guarantee can have the financial report reviewed. Small companies limited by guarantee are not required to prepare and lodge financial reports.
- **Grant acquittals**
  - Many grants received will require acquittal reports periodically, often at the end of each financial year, to ensure monies are being spent as per the grant agreement.
  - The format of these acquittals is usually provided in the grant deed or other agreement.
  - Consider whether any unspent funds are allowed to be rolled over from year to year and request a revised agreement with the funding body when appropriate. Note: some Grant Deeds cover this need for a revision, including the timing for any changes to be approved.
- **State government** – Typically, Incorporated Associations must report to their respective State Government Department annually, if not registered with and reporting to ACNC. This usually includes financial reports (audited or reviewed, depending on legislative requirements and the Rules of the Association) and sometimes other information.
- **Other government departments or statutory bodies** – May require reporting, depending on the NFP's registrations and requirements. For example, registered Indigenous Corporations must lodge an annual report with the Office of the Registrar of Indigenous Corporations.

For further information, refer to the CPA Australia guide **"Charities: A guide to financial reporting and assurance requirements".**

Audit/Review (assurance of financial reports)

An "Audit" or "Review" of a financial report is a form of "assurance" provided by an "assurance practitioner" (typically a professional auditor) that is intended to increase the confidence of the users of the financial report. A "Review" is a limited or lesser form of assurance than an "Audit".

An audit or review is mandatory for some NFPs (for example large and medium sized NFPs registered with ACNC, some NFP companies limited by guarantee and most NFPs who receive grants) and is also dependant on the requirements contained in the NFPs Constitution/Rules of Association.

For further detailed information on statutory reporting and audit/review requirements discussed above, refer to the CPA Australia guide **"Charities: A guide to financial reporting and assurance requirements".**

Tax and payroll related obligations (compliance)

Goods and Service Tax (GST)

Goods and Service Tax (GST) applies to many types of income and expenses, however, there are many exceptions also. There are additional GST concessions for some NFP charities as well, for example, a school canteen, a fundraising event, or a non-commercial activity.

- The turnover threshold for an NFP is $150,000 per annum (i.e. NFPs with GST turnover below this threshold can choose whether or not to register for GST. It is recommended to engage with a registered tax/BAS agent to determine whether to register if under the threshold. This consideration may be relevant, for example where an NFP with predominantly GST-free income may still be able to receive GST refunds from their purchases, or if a larger capital works project that attracts GST is occurring).
- Cash or Accrual basis for GST reporting is also dependent on the size of the NFP and which method is the most appropriate. Once again this is best considered in conjunction with a registered tax/BAS agent.
- Reporting cycle can be monthly, quarterly or yearly reporting and associated payment or refund.
- Lodgement to the ATO via an Activity Statement using ATO Online Services for Business, via a registered tax/BAS agent or via hard-copy in exceptional circumstances.

Pay-as-you-go Withholding (PAYGW)

Pay-As-You-Go Withholding (PAYGW) is a withholding tax on staff wages and contractor fees in some instances. It is a deduction from the wages (or contractor fees) paid directly to the staff member (or fees to a contractor) and these withheld amounts are required to be paid to the ATO.

- Registration is required wherever there are staff being paid a wage. This may include board/committee members if they are in paid positions.
- The reporting/payment cycle can be monthly or quarterly.
- Lodgement is required with to the ATO via an Activity Statement.

Note that PAYGW and GST cycles are not always in alignment – i.e. it is not uncommon for an NFP to be reporting and paying PAYGW on a monthly basis (via an Instalment Activity Statement (IAS)), while only reporting and paying GST on a quarterly basis (via a BAS). The period covered for each is shown on the relevant Activity Statement. In this situation, the last month of a quarter for PAYGW will be included with the GST on a quarterly BAS.

For example, the July and August IAS will include the respective PAYGW for each of those months, while the September BAS will include three months of GST (July, August and September) and only one month (September) of PAYGW.

Fringe Benefits Tax (FBT)

Fringe Benefits Tax (FBT) is applicable on benefits over and above wages and salaries, that have been provided to staff, volunteers, board/committee members and their families or associates. The two most common Fringe Benefits for NFPs are:

- motor vehicle private use (where the vehicle is owned by NFP)
- entertainment.

Some NFP Charities have FBT Rebate or FBT Exemption status. These ATO concessions should be discussed and reviewed with the ATO or a registered tax agent with NFP experience to fully understand the FBT implications. A few common misunderstandings include:

- FBT Rebate concession allows Fringe Benefits to be provided without any further taxation (NOT true).
- FBT Exemption status allows unlimited Fringe Benefits (NOT true).
- Private use of a NFP-owned vehicle can be in addition to the benefits already being salary sacrificed up to the maximum threshold for an NFP with FBT Exemption (NOT true).
- Travel between a staff member's home and an NFP office is work travel (NOT true – generally this is deemed private use by the ATO, with some exceptions – for example emergency vehicles required for call-outs).

The FBT year is from April 1 to March 31 the following year. A FBT return must be lodged with the ATO each year for NFPs that provide Fringe Benefits with quarterly instalments usually payable on a quarterly BAS.

Income Tax

Most NFPs are income-tax exempt. However, there are some that do need to prepare and lodge an annual income tax return, similar to a for-profit company (e.g. some sporting organisations and political parties). Where an income tax return is required, the principle of "mutuality" applies to most taxable NFPs. This means the income and expenses relating to members is excluded. ATO references:

https://www.ato.gov.au/Non-profit/Your-organisation/Does-my-not-for-profit-need-to-pay-income-tax-/income-tax-exempt-organisations/

Refer to ATO document with Quick Code QC 23099 "Mutuality and taxable income" for more detail.

Note that it is being proposed that from 1 July 2023 there will be further self-assessment requirements to be lodged via the ATO for NFPs that are income tax exempt. Refer to **https://www.ato.gov.au/Non-profit/** for further information.

Superannuation

Superannuation is payable on behalf of all staff, with a few exceptions (in particular staff under 18 years of age or 75 and over have some specific conditions). Superannuation is calculated as a percentage of "Ordinary Times Earnings" (essentially gross wages less various payments such as overtime, certain allowances and types of leave) and paid directly to the applicable staff superannuation fund accounts.

The percentage rate is currently legislated to increase by 0.5 per cent per year from 2021 to 2025 (from 9.5 per cent to 12 per cent). It should be noted that in some cases the percentage amount can be above the standard rate (e.g. some pay awards, enterprise bargain arrangements (EBA) or contractual). The standard superannuation rates for this year and the next four years are as follows:

- Year to 30 June 2023 – 10.5 per cent
- Year to 30 June 2024 – 11.0 per cent
- Year to 30 June 2025 – 11.5 per cent
- Year to 30 June 2026 – 12.0 per cent
- Year to 30 June 2027 – 12.0 per cent.

Contractor payments may also attract superannuation if the payment is mainly for their labour.

Reporting and payment of superannuation can typically be done automatically through most SuperStream-compliant accounting and payroll systems. Other options do exist via the ATO website and super fund portals. The deadline for this reporting and payment is within 28 days after the end of each quarter:

- Quarter 1 (July to 30 September) due by 28 October
- Quarter 2 (October to December) due by 28 January
- Quarter 3 (January to March) due by 28 April
- Quarter 4 (April to June) due by 28 July.

Given the complexities around determining Ordinary Times Earnings it is recommended to contact the ATO and/or seek specialist advice if at all unsure whether contractors should be treated as employees. This is especially the case for superannuation and other elements of the legislation.

For further ATO information: **www.ato.gov.au/Super/**.

The Fair Work Ombudsman also provides some information for the benefit of employees working under awards, enterprise agreements and other registered agreements that have extra terms about superannuation.

For further Fair Work Ombudsman information: **https://www.fairwork.gov.au/pay-and-wages/tax-and-superannuation**

Work Cover/Workers Compensation Insurance

This is covered by the relevant legislation in each state and territory. Generally, this type of insurance is mandatory for any employer of staff (and sometimes contractors and volunteers). Refer to an insurance broker for further information and to assist with getting the correct insurance cover in place.

Glossary of Terms/Index

Note: the following definition glossary is for general reference and is not necessarily the legal or technical meaning for some terms. It is recommended that specialist advice is sought that is relevant to the NFP, where required.

AASB – Australian Accounting Standards Board.

Accounts Receivable – amounts owed by customers, clients and funding bodies, generally reflected in a register or module within the accounting system.

Accrual basis of accounting – the effects of transactions and other events are recognised when they occur (and not when cash or its equivalent is received or paid). They are recorded in the accounting records and reported in the financial statements in the periods to which they relate.

ACNC – Australian Charities and Not-for-profits Commission.

Amortisation/Depreciation – the systematic allocation of the depreciable amount of an asset over its useful life.

Asset – a resource: (a) controlled by an entity as a result of past events and (b) from which future economic benefits are expected to flow to the entity.

ASIC – Australian Securities and Investments Commission.

ATO – Australian Taxation Office.

Audit – a formal examination of the NFP's financial statements/records by an independent assurance practitioner.

Audit (AUASB definition) - a reasonable assurance engagement in which the assurance practitioner reduces engagement risk to an acceptably low level in the circumstances of the engagement as the basis for the assurance practitioner's conclusion. The assurance practitioner's conclusion is expressed in a form that conveys their opinion on the outcome of the measurement or evaluation of the underlying subject matter against criteria.

Balance Sheet - a statement as at a point in time (typically at the end of a month, quarter or year) that includes the NFP's assets, liabilities and equity.

Bank Reconciliation – a process of matching the bank receipts and payments recorded in the accounting system with a bank statement or other document from the bank.

BAS – Business Activity Statement. An ATO statement that typically includes GST, PAYGW (and FBT and Income Tax instalments where applicable).

Bequest – monies provided to an NFP upon the death of someone via a deceased estate, typically covered by a person's will.

Board/Committee – the group of people that oversee the NFP strategic direction and governance as specified in the NFP constitution or rules. The board/committee will often have a legal duty of care over the administration of the finances of an organisation in a responsible and diligent manner. These people are also referred to as "responsible persons" or "office bearers".

Budget – a future plan or estimate of income and expenses. Typically a budget is for a 12 month period, drawn-up by management and approved by the board/general committee.

Capital expenditure – purchases of assets, such as equipment, vehicles or property with an economic and useful life greater than 12 months. This can also include Intangible Asset purchases (software, website developments or goodwill arising on the purchase of a business or entity).

Cash basis of accounting – recording and/or reporting accounting transactions on the basis of when monies have been received or paid (as opposed to accrual basis of accounting. See above).

Cash Buffer – having adequate cash in the bank to cover expenditure over a period of time into the future.

Cash flow statement - a statement showing the cash inflows and outflows during the year.

Charity – a type of NFP with charitable purposes that is/are for public benefit, do not have disqualifying purposes, and are not an individual, political party or government entity.

Constitution – the rules of the NFP including its structure, governance processes, goals and objectives. This document can also be known as the "Rules of Association" or the "Governing document".

Controls – a system of policies, procedures and processes that help ensure accuracy, reliable reporting, promotes compliance and reduces the risk of fraud or errors.

Cost of Goods Sold – expenses directly related to sales revenue. For example, food and drink for re-sale at a sports club canteen.

Culture – shared beliefs and values of the NFP. Typically, an NFP's culture is established by reference to the constitution, consultation with internal and external stakeholders and developed and led by management and board/committee.

Current Assets – assets (items expected to generate future economic benefit) that are realised within 12 months (such as cash at bank, accounts receivable, inventory/stock and prepaid expenses).

Current Asset (AASB definition) – an entity shall classify an asset as current when (a) it expects to realise the asset, or intends to sell or consume it, in its normal operating cycle, (b) it holds the asset primarily for the purpose of trading, (c) it expects to realise the asset within twelve months after the reporting, or (d) the asset is cash or a cash equivalent unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.

Current Liabilities – amounts owed within the next 12 months (such as accounts payable (monies owed to suppliers), accrued expenses, staff annual and current long service leave, ATO-related (GST, PAYGW, FBT) and superannuation.

Current Liability (AASB definition) - an entity shall classify a liability as current when, (a) it expects to settle the liability in its normal operating cycle, (b) it holds the liability primarily for the purpose of trading, (c) the liability is due to be settled within twelve months after the reporting period, or (d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period.

Deficit – when the cost of sales and expenses exceeds income for a period of time. Also known as "Loss" and can be identified on a "Profit and Loss" or "Income Statement".

Delegation Limits – monetary thresholds for approved expenditure by various staff (or their position titles), volunteers, managers and/or board/committee members.

DGR – Deductible Gift Recipient. An endorsement through the ATO (that can be applied for via the ACNC) provided to NFPs that allows individuals and organisations to donate tax-deductible monies or property of value to a DGR-endorsed NFP (i.e. the donor can claim a tax deduction in their own income tax return for the monies or property donated).

Donation – To be regarded as a donation for ATO-purposes the monies or property must be gifted TO A DGR-ENDORSED NFP without the provier receiving any direct benefit in return.

EFT – Electronic Funds Transfer. An electronically generated transaction via an online banking system (e.g. to pay/reimburse staff, suppliers and volunteers).

Equity – the retained earnings and reserves of an NFP. This is equal to total assets less total liabilities. It is equal to the net financial position of the NFP as at the reporting date.

Equity (AASB definition) - the residual interest in the assets of the entity after deducting all its liabilities.

Expenses – the financial value of goods purchased, or services obtained by an NFP.

FBT – Fringe Benefits Tax. A tax administered by the ATO and applied to payments and other items of value provided as a benefit to staff, volunteers and their associates where there hasn't already been tax applied via payroll (PAYGW) or some other exemption or concession applies.

FBT Exemption status – an ATO concession applied to some NFP Charities that allowe benefits up to a certain threshold to be provided without income tax or FBT being applied. Generally, the NFP Charity must have PBI (Public Benevolence Institution) or HPC (Health Promotion Charity) status before receiving this exemption.

FBT Rebate status - an ATO concession applied to some NFP Charities which allows a portion of FBT to be rebated (deducted). This status should not be confused with the "FBT Exemption status" (see above).

Fiduciary duty – the requirement for board/committee members and office bearers to act in good faith and in the interests of the NFP and its members. This includes prevention of insolvent trading and other voidable transactions not in the interests of the organisation, among other statutory obligations. For many office bearers of NFPs, this can be a legal requirement.

Financial Report – typically a report containing a Profit and Loss statement, Balance Sheet, Budget/Forecast, Cashflow Statement, notes accompanying these statements and similar reports. The term "financial report" is sometimes defined in law.

Financial Statements – a term that is often used interchangeably with the term "financial report" (see above), containing information similar to a financial report. Financial statements can also be prepared as end of year reports in accordance with Australian Accounting Standards (sometimes also called "Statutory Accounts").

Financial sustainability – ability to remain profitable, or financially viable into the future or have enough cash reserves to continue operations into the medium to longer term.

Financial Year – usually 1 July to 30 June the following year, although some NFPs will have a different start and end date.

Fixed Assets – a type of Non-Current Asset (an item that holds economic value beyond 12 months) that has physical form, such as office furniture, motor vehicles, computer equipment and leasehold improvements.

For-Profit – an organisation that has an objective to earn profit (positive net income i.e. total income greater than total expenses) for its owners/shareholders/members.

Funding Body – an organisation (e.g. a government department, a trust, foundation, or other organisation) that provides funding to NFPs, typically as a grant.

General Journal (also known as a Journal Entry) – an accounting entry with equalising debits and credits used to record a transaction, correct a previous transaction, re-allocate amounts, adjust end-of-period accruals or provisions and other transactions.

Going Concern - the ability for an NFP to continue to operate into the foreseeable future (usually 12 months). This particularly needs to be considered when preparing financial statements (refer to AASB 101 (p25).

Governance - systems, processes, procedures and controls that the board/committee oversees.

Grant Income – monies provided to an NFP, e.g. from a government body, a trust or foundation, for the NFP to provide certain goods or services to the community. A grant is usually documented within a grant deed (legal contract or other document detailing the terms of agreement of what the NFP needs to do in exchange for receiving the monies).

GST – Goods and Service Tax, as administered by the ATO, applies to most sales and purchaseswith some exceptions. Further information can be found on the ATO website: **https://www.ato.gov.au/Business/GST/**

Honorarium – a token payment provided to a volunteer, including sometimes to board/committee members. Refer to ATO website for further details for tax purposes: **https://www.ato.gov.au/Non-profit/Types-of-Not-for-profit-workers/Not-for-profit-volunteers/Paying-volunteers/Honorariums/**

IAS – Instalment Activity Statement. An ATO-administered statement for reporting PAYGW and/or Income Tax instalments, usually on a monthly or quarterly basis.

Income – in general, the financial or monetary value given to the sale of goods or services provided other parties, monies received by the NFP as a gift (usually a donation or bequest) or monies received as a grant from a government body or other organisation to continue the NFP's services to the community.

Income (AASB definition) - increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.

Income Statement (also known as a Profit and Loss statement) - a statement showing the income and expenses of the NFP over a specified period of time (typically a month, quarter or year).

Income Tax – a tax administered by the ATO for the net income (income less expenses) for most individuals, for-profit organisations and some NFPs.

Indigenous Corporations – an organisation registered with the Office of the Registrar of Indigenous Corporations. Refer to **www.oric.gov.au**.

Insolvency Practitioner – a specialist who is licensed with ASIC as a "Registered Liquidator".

Internal Audit – generally a function only in larger NFPs, this is a process of reviewing and interrogating policies, procedures and controls to determine whether they are appropriate and being followed.

Journal entry - refer to General Journal.

Liabilities - financial amounts owed by the NFP to other parties, typically in the form of money.

Liability (AASB definition) - a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Loss – when the expenses exceed the income for a period of time. Also known as "Deficit" and can be identified on a "Profit and Loss" or "Income Statement".

Management – staff with senior and/or supervisory roles.

Member – for an NFP this is usually defined in its constitution and includes people or organisations that wish to be involved with the NFP as an equity stakeholder and/or wish to receive some services or other benefit (but not a financial return) from the NFP.

Net Income – total income less total expenses. Sometime used instead of the term Profit/Loss or Surplus/Deficit.

Non-Current Assets - items that provide economic value beyond 12 months, such as office furniture, motor vehicles, computer equipment, leasehold improvements, goodwill, right-of-use assets and long-term investments.

Non-current asset (AASB definition) - an asset that does not meet the definition of a current asset.

Non-Current Liabilities – amounts owed beyond 12 months, such as long service leave for staff not currently owed, lease liabilities and loans.

Objectives – usually included in the NFP's constitution setting out what the NFP wishes to achieve.

Office Bearers – executive management (e.g. CEO, CFO and general manager) and board/committee members with specific roles as defined by ACNC, ATO, ASIC and/or in the NFP's constitution – such as public officer, secretary, chair/president or treasurer/director of finance.

PAYGW – Pay-As-You-Go-Withholding is a withholding tax on staff wages and contractor fees, administered by the ATO.

PBI (Public Benevolence Institution) – an ATO-endorsed type of charity that allows additional taxation concessions beyond the usual concessions for charities, particularly FBT Exemption and DGR (Deductible Gift Recipient status). A PBI must have a "main purpose to relieve poverty, sickness, suffering or disability".

Policies and Procedures – a documented system of how tasks are undertaken within the NFP.

Profit – when the income exceeds the expenses for a period of time. Also known as "Surplus" and can be identified on a "Profit and Loss" or "Income Statement".

Profit and Loss Statement – see Income Statement above.

Reserve – a type of account showing in the Equity section of the Balance Sheet, including balances created from asset revaluations from Retained Earnings, or transfers from retained earnings earmarked for specific programs or purposes.

Retained Earnings – a type of account presented in the Equity section of the Balance Sheet, consisting of accumulated prior and current period surpluses (profits) less accumulated prior and current period deficits (losses).

Review - a lower level of assurance compared to an audit.

Review engagement (AUASB definition) – a limited assurance engagement where the assurance practitioner's objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the assurance engagement. This occurs where that risk is greater than that for a reasonable assurance engagement, as the basis for a negative form of expression of the assurance practitioner's conclusion. A limited assurance engagement is commonly referred to as a review.

Risk – exposure to a threat that may be detrimental to an NFP (financially, strategically, operationally and reputationally), but can also have upside benefit if managed appropriately e.g. taking a risk with a new project or program or investing monies.

Risk Appetite – a determination as to the tolerable level of risk that the NFP is willing to accept.

Risk Management – a system of policies, procedures, registers and controls for managing risk.

Rules of Association - the rules or guidelines of the organisation, including its structure, governance processes and usually specifying its goals and objectives. Can also be known as the "Constitution" or the "Governing document".

Segment (Profit and Loss) **Report** – report showing income and expenditure for each program, event, cost/profit centre or division. Often used to keep track of grant funds, or monitor the performance of a program, event or division of the NFP.

Segregation of Duties – having more than one person responsible for the same or similar duties, or process. For example:

- One person raises a sales invoice while another records payment against the invoice.
- One person counts the money from a fundraiser while another checks and deposits the money at the bank.
- One person approves and enters a supplier invoice for payment while another completes all supplier payments.

Solvency – an organisation is "solvent" if it can pay its debts as and when they fall due and payable.

Source Document – the original document relating to a transaction. Typically a supplier invoice/receipt, sales invoice, worksheet calculation for a journal entry or timesheet/pay record for payroll.

Strategic Planning – typically involves management and board/committee (but sometimes other staff as well) to review the NFP's objectives, update if necessary and make plans for how to achieve the objectives into the future. This planning process often aligns with financial budgets and forecasts.

Superannuation (Super) – monies paid to provide for staff (and potentially contractors') retirement. It is legally required to be paid to complying super funds at an ATO-set percentage rate of wages, at least on a quarterly basis. Office bearers of the NFP are legally responsible for ensuring that superannuation is paid at the correct rate and within required timeframes. Non-compliance can result in significant financial and legal repercussions. Refer to **www.ato.gov.au/super**

Surplus – when the income exceeds the expenses for a period of time. Also known as "Profit" and can be identified on a "Profit and Loss statement" or "Income Statement".

Tied Funds – monies that have been received (usually via a grant) that are yet to be spent on the program or project for which they were received. Tied Funds could also be determined by the board/committee by designating assets for a specific purpose and via the set-up of a Reserve in the Equity section of the Balance Sheet.

Volunteer – a person who provides their labour or expertise to an NFP without receiving any monetary or item of value in return. Sometimes an honorarium can be paid, which is a token payment for the labour or expertise provided.

Whistle-blowing – an employee, volunteer, board/committee member, person from the public or some other stakeholder reporting an issue in relation to the organisation, typically of relatively large significance.

WorkCover/Workers Compensation Insurance – legally payable by all organisations that employ staff (or have close working contactors) in all Australian states and territories to help cover for accidents or injuries incurred in the workplace. Typically, an additional cover or a separate insurance policy is required to cover workplace accidents or injuries of volunteers.

APPENDIX A

General ratios and checklists relevant to all NFPs

Ratios

Liquidity ratios

$$\textbf{Current ratio} = \frac{\textbf{Total current assets}}{\textbf{Total current liabilities}}$$

One of the most common measures of financial strength, this ratio enables the organisation to see if it has current assets sufficient to meet its due debts with a margin of safety. A generally acceptable current ratio is 2 to 1. However, this will depend on the nature of the NFP and the form of its current assets and liabilities. For example, an NFP may have current assets made up predominantly of cash and would therefore survive with a lower ratio.

$$\textbf{Quick ratio} = \frac{\textbf{Total current assets – inventory}}{\textbf{Total current liabilities}}$$

Sometimes called the "acid test" ratio, this is one of the best measures of liquidity. By excluding inventory which could take some time to realise unless the price is "knocked down", it concentrates on real, liquid assets. It helps to answer the question: "If the organisation does not receive income, will it be able to meet its current obligations with the readily convertible 'quick' funds on hand?"

Solvency ratios

$$\textbf{Leverage ratio} = \frac{\textbf{Total liabilities}}{\textbf{Equity}}$$

The leverage (or gearing) ratio indicates the extent to which the organisation is reliant on debt financing versus equity. Generally speaking, the higher the ratio, the more difficult it will be to borrow more money.

$$\textbf{Debt to assets} = \frac{\textbf{Total liabilities}}{\textbf{Total assets}}$$

This measures the percentage of assets being financed by liabilities. Generally speaking, it should be less than 1, indicating adequacy of total assets to finance all debt.

$$\textbf{Interest coverage} = \frac{\textbf{Net profit (before interest and tax where relevant) liabilities}}{\textbf{Total interest}}$$

This measures how many times net profit covers interest expense obligations. The higher the ratio, the more likely the organisation will be able to be able to meet its interest expenses.

Operational benchmarks

$$\textbf{Activity expense benchmark} = \frac{\textbf{Activity expenses}}{\textbf{Activity income}}$$

For example:

$$\textbf{Fundraising ratio} = \frac{\textbf{Fundraising expenditure}}{\textbf{Fundraising income}}$$

This ratio measures cost of fundraising against the income derived from fundraising. It can be used for discrete activities within the NFP.

$$\textbf{Activity expense to total expense benchmark} = \frac{\textbf{Activity expense}}{\textbf{Total expense}}$$

This is the ratio of the cost of the activity to total expenditure. It allows management to see quickly which activities are the most expensive.

$$\textbf{Activity expense to total income benchmark} = \frac{\textbf{Activity expenses}}{\textbf{Total income}}$$

For example:

$$\textbf{Fundraising expense to net income} = \frac{\textbf{Fundraising expense}}{\textbf{Net income}}$$

This shows fundraising expenses as a fraction of the total of all income derived from the activities of the NFP. Where this ratio is calculated for each discrete activity within the NFP, management can clearly see which fundraising activities are the most expensive.

$$\textbf{Activity income to total income benchmark} = \frac{\textbf{Activity income}}{\textbf{Total income}}$$

$$\textbf{Fundraising income to net income ratio} = \frac{\textbf{Fundraising income}}{\textbf{Net income}}$$

This is the ratio of the income from fundraising to the net income derived from all the activities of the NFP. Where this ratio is calculated for each discrete activity of the NFP, management can clearly see which activities generate the highest proportion of the NFPs net income.

Balance sheet ratios

$$\text{Return on assets} = \frac{\text{Net profit before tax}}{\text{Total assets}} \times 100$$

The return on assets indicates how efficiently profits are being generated from the assets employed in the organisation. The ratio will only have meaning when it is compared with the corresponding ratios of similar organisations. If the ratio of the organisation is low in comparison with those of similar organisations, it could indicate that the assets are being used inefficiently.

$$\text{Return on equity} = \frac{\text{Net profit before tax}}{\text{Equity}} \times 100$$

The ROE is a ratio that identifies whether or not the organisation is making a return on the funds it raises and receives. It is worth noting that this ratio should not be considered in isolation in any given year, as the funding of a NFP can vary from year to year.

Checklists

Risk assessment checklist

A risk is anything that could jeopardise the achievement of any of the organisation's key objectives. Asking the following questions may assist to identify risks to an NFP:

Risk assessment checklist

- [ ] What needs to be done to achieve strategic objectives?
- [ ] Are there any aspects of the organisation that are vulnerable?
- [ ] How is the organisation's reputation managed?
- [ ] What assets need to be protected?
- [ ] Is fraudulent activity within the organisation possible?
- [ ] Is disruption to the organisation's operations possible?
- [ ] How does the organisation monitor the achievement of its objectives?
- [ ] What information does the organisation place heavy reliance on?
- [ ] What activities does the organisation spend the highest portion of funds on?
- [ ] Is there an overreliance on sources of revenue or grants from one or a limited number of sources?
- [ ] How is revenue earned, billed and collected?
- [ ] Which activities of the organisation are the most complex?
- [ ] Which activities of the organisation are regulated?
- [ ] What is the organisation's greatest legal exposure?

Financial controls checklist - general

To manage the risk of financial transaction processing failures, manual or automated control procedures should be implemented at key stages of the process.

Some of the questions that can be asked are:

- How well are the financial aspects of the organisation managed?
- Are the organisational operations protecting the organisation against disasters, internal theft and unfavourable external audits?
- How comprehensive are management practices?
- Are the financial records accurate?

Review the following checklist. Organisations with sound financial management practices should answer "yes" to most of the following questions:

1. General

	Yes
Is a chart of accounts used?	
Is it detailed enough to give adequate management information?	
Is a double entry bookkeeping system used?	
Are journal entries used?	
Are journal entries approved?	
Are budgets and cash projections used which: • compare to actual results? • are investigated if there are major discrepancies?	
Do key personnel, management committee and/or the board understand the form and contents of the financial statements?	
Are comparative financial statements produced and reviewed?	
Are the books and records kept up-to-date and balanced?	
Is financial information produced regularly?	
Are reasonable due dates for preparation of financial information imposed?	
Are storage facilities safe?	
Is insurance cover regularly reviewed?	
Is a records retention schedule in place?	
Is insurance cover regularly reviewed?	
Is a records retention schedule in place?	

2. Cash receipts

	Yes
Does a responsible employee other than the bookkeeper or person who maintains accounts receivable: • open the mail and pre-list all cash receipts before turning them over to the bookkeeper? • stamp all cheques with restrictive endorsement "for deposit only" before turning them over to the bookkeeper? • compare daily prelisting of cash receipts with the cash receipts journal and the duplicate deposit slip?	
Are cash receipts deposited intact on a daily basis?	
Are cash receipts posted promptly to appropriate journals?	
Are cash sales controlled by cash registers or pre-numbered cash receipts forms?	

3. Cash used (disbursements)

	Yes
Are all disbursements, except for petty cash, made by cheque or internet payment?	
Are cheques pre-numbered and all numbers accounted for?	
Are all cheques recorded when issued?	
Are all unused cheques safeguarded with access limited?	
Is a mechanical cheque protector used to inscribe amounts as a precaution against alteration?	
Are voided cheques retained and mutilated?	

4. Cash used (disbursements) continued

	Yes
Are all cheques and internet payments viewed and signed?	
If a signature plate is used, who has control of this?	
Are supporting documents, processed invoices, receiving reports and purchase orders presented with the cheques reviewed before the manager signs the cheques?	
Are supporting documents for payments properly cancelled to avoid duplicate payments?	
Are cheques payable to cash prohibited?	
Are signed cheques mailed by someone other than the person who writes them?	
Are bank statements and cancelled cheques: • received directly by a responsible employee? • reviewed by a responsible employee before they are given to the bookkeeper?	
Are bank reconciliations prepared: • monthly for all accounts? • by someone other than the person authorised to sign cheques or use a signature plate?	
Are bank reconciliations reviewed and adjustments of the cash accounts approved by a responsible person other than the bookkeeper?	
Are all disbursements from petty cash funds supported by approved vouchers?	
Is there a limit on the amounts of individual petty cash disbursements?	
Are petty cash funds on an imprest basis (the total amount is set e.g. $100, only up to this amount can be spent and it's only topped up with what's spent)?	
Are petty cash funds: • kept in a safe place? • sufficient to require only monthly reimbursement? • controlled by one person? • periodically checked by someone other than the custodian?	

5. Employees

	Yes
Are all employees' job references checked?	
Are individual personnel files maintained?	
Is access to personnel files limited to a person who is independent of the payroll or cash functions?	
Are wages, salaries, commissions and piece rates approved?	
Is proper authorisation obtained for payroll deductions?	
Are adequate time records kept for employees paid by the hour?	
Are salesmen's commission records reconciled with sales records?	
If employees punch time clocks, are the clocks located so they may be watched by someone in authority?	
Are time records for hourly employees approved by a foreman or supervisor?	
Are there controls to ensure that the absence of any employee is noted?	
Is the accuracy of the payroll checked?	
Are payroll registers reviewed by a responsible person?	
If employees are paid in cash, is the cash requisition compared to the net payroll?	
Is there control over unclaimed payroll checks?	
Are staff cross-trained in accounting functions?	
Are annual vacations required?	

Review those questions in the checklist that are applicable to the organisation but for which a "yes" answer has not been provided. Ask management to implement appropriate policies and procedures, including naming the people who will be responsible for them and a completion date. When the appropriate policies and procedures have been set up, a "yes" answer should be possible for all the questions. This checklist should be reviewed annually by the board or management committee.

Financial management governance checklist

The following is a list of key areas of financial management that need to be overseen by the board or committee of management.

Solvency – making sure that the organisation:

	Yes
Can pay all bills when due and payable.	
Has adequate funds in the accounts for scheduled bills and expenses.	
Has the ability to access funds as and when required.	
Can fund all its programs and all other contractual obligations.	
Regularly reviews its cash flow forecast, identifies any variances and notes their potential impact on solvency.	

Budgeting – ensuring that:

	Yes
All expected income and expenditure is included.	
All sources and amounts of income are identified.	
All expenditure included in the budget is approved.	
Expenditure is not greater than income.	
The annual budget is approved.	
There is a regular review of budget to actual results (monthly, quarterly).	
The impact of any variances from budget to actual are identified and explained.	
The budget is amended where material changes have occurred that impact original budgeted income and expenditure.	

Financial statements – ensuring that:

	Yes
Appropriate record-keeping is maintained.	
Key financial accounts are regularly reconciled.	
There is regular reporting of income and expenditure, balance sheet, cash flow statement, budgets and forecasts.	
Financial statements are audited annually.	
The balance sheet is reviewed for the financial health of the organisation.	
Appropriate financial controls are in place for accurate records.	

Preventing fraud and mismanagement – ensuring that:

	Yes
Controls are in place to safeguard assets.	
Money is used in line with approved budgets.	
Controls are in place for approval of spending.	
Controls are in place for banking transactions.	

Review those questions in the checklist that are applicable to the organisation but for which a "yes" answer has not been provided. Ask management to implement appropriate policies and procedures, including naming the people who will be responsible for them and a completion date. When the appropriate policies and procedures have been set up, a "yes" answer should be possible for all the questions. This checklist should be reviewed annually by the board or management committee.

Internal controls checklist

Internal control activities generally include approvals, authorisations, verifications, reconciliations, reviews of performance, security of assets, segregation of duties and controls over information systems. Essentially control activities will assist in deterring, preventing and disclosing risk events in the organisation.

The following checklist can be used to help identify internal controls that are either currently used or required within the organisation.

Internal control activity	Description
Performance reviews	Management compares information about current performance to budgets, forecasts, prior periods or other benchmarks (such as similar NFPs) to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
Security of assets	Access to equipment, inventories, securities, cash and other assets (including intellectual assets) is restricted and physical controls, such as locks, security systems and passwords. Individuals have restricted access in line with authorisations. Assets are periodically counted and compared to amounts shown on control records.
Segregation of duties	Duties are segregated among different people to reduce the risk of error or inappropriate actions. Normally, responsibilities for authorising transactions, recording transactions (accounting) and handling the related asset (custody) are divided.
Approvals, authorisations, verifications	Management authorises employees/volunteers to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies activities or transactions that need supervisory approval before they are performed or executed by employees or volunteers. A supervisor's approval implies that the activity or transaction is in line with the established policies and procedures.
Reconciliations	Different sets of data are compared and any differences in the data are identified and investigated. Where necessary, corrective action is taken to resolve differences and to ensure the accuracy and completeness of transactions that have been charged to a department's accounts. Reconciliations should be documented and approved by management.
General information systems controls	Controls over data centre operations, system software and hardware acquisition and maintenance, access security, application system development and maintenance are implemented.
Application information systems controls	Computer application systems specific to individual applications are monitored, including input controls (e.g. edit checks), processing controls (e.g. record counts) and output controls (e.g. error listings).

APPENDIX B

Ratios and checklists for NFPs that trade in goods and/or services

Managing profitability and cash flow

Profitability (Surpluses)

Where an NFP has trading activities, they must be profitable to ensure that they do not erode cash reserves. This section discusses the ways of measuring profitability applicable to NFPs that have trading activities and those that rely solely on contributions.

It is noted that many NFPs will refer to Profits as a "Surplus" but this document uses the term "Profit" to align with the standard accounting terminology.

Monitoring profitability (surpluses)

The following tools can be used to monitor profitability to understand:

- whether the NFP's profits are being eroded by increasing prices in stock or other expenses.
- how to set new selling prices when stock costs increase (mark up).
- how much needs to be sold before the organisation starts making a profit (break even analysis).

Margin

There are two margins that need to be considered when monitoring profitability: gross and net. For most NFPs only net margin would be relevant. However, for those that trade, gross margin should also be reviewed.

Gross margin is the difference between the cost of goods sold and net sales. By "net sales" we mean all the sales dollars less any discounts that have been given to the customer and commissions paid to sales representatives. The selling price of goods must be higher than the cost of buying them. Gross margin is not commonly used for service organisations as they most often do not have "cost of goods sold".

The margin can be expressed either in dollar value (gross profit) or in a percentage value that measures the percentage of sales dollars remaining (after obtaining or manufacturing the goods sold) available to pay the overhead expenses of the company.

Net margin is the sales dollars left after subtracting the cost of goods sold and the overhead expenses. The net margin tells the NFP how much profit has been made before any tax. Tax is not included in net margin because tax liabilities can vary from one NFP to another, making comparison after taxes much more difficult. Net margin can be expressed either in dollars (net profit) or as a percentage.

Mark up

Mark up is the amount that goods are sold for above what it cost to purchase them. It is generally only meaningful when it refers to the sale of products (as opposed to services). It can be useful to calculate mark up to ensure the selling price will cover all the costs of the sale.

Break even calculation

The break even calculation shows how many sales have to be made, in either dollars or units, before all expenses are covered and actual profit arises.

Ratios for monitoring profitability

Gross margin ratio

Dollar value =	Net sales less cost of goods sold	= Gross profit
Percentage value =	$\frac{\text{Gross profit dollars}}{\text{Net sales dollars}} \times 100$	= Gross margin

Net margin ratio

Dollar value =	Net sales less total of both cost of goods sold and overhead expenses	= Net profit
Percentage value =	$\frac{\text{Net profit dollars}}{\text{Net sales dollars}} \times 100$	= Net margin

Mark up ratio

Percentage value =	$\frac{\text{Sales – cost of goods sold}}{\text{Cost of goods sold}} \times 100$	= Mark up

Break even ratio

Dollar value =	$\frac{\text{Expenses}}{\text{1 – (cost of goods sold/total sales)}}$	= the total sales value needed before a net profit will occur
Number of units =	$\frac{\text{Expenses}}{\text{(Unit selling price – unit cost to produce)}}$	= the total number of units needed to be sold before a net profit will occur

Profitability ratios

$$\text{Gross margin benchmark} = \frac{\text{Gross profit}}{\text{Net income}}$$

This ratio measures the percentage of sales dollars remaining (after obtaining or manufacturing the goods sold) available to pay the overhead expenses of the organisation. This ratio is only relevant to the trading segments of the NFP.

$$\text{Net margin benchmark} = \frac{\text{Net profit}}{\text{Net income}}$$

This measures the percentage of sales dollars left after all expenses (including stock), except income taxes. It provides a good opportunity to compare NFP's "return on income" with the performance of other NFPs.

Working capital ratios

$$\text{Days' inventory} = \frac{\text{Inventory}}{\text{Cost of goods sold}} \times 365$$

$$\text{Days' debtors} = \frac{\text{Debtors}}{\text{Net income}} \times 365$$

$$\text{Days' creditors} = \frac{\text{Creditors}}{\text{Cost of goods sold}} \times 365$$

Discounting sales

If the organisation has trading activities, then it is possible profits can be eroded where sales are discounted to entice customers to purchase the goods or services. Of course, some discounting can be beneficial. However, it is important that the impact of discounting on profit is understood before a decision to offer discounts is made. Alternatives, uch as add-on products or services, may deliver more dollars of gross profit to the organisation and should be considered before deciding to offer discounts.

Discounting is effectively offering goods or services at a reduced selling price. Where discounts are offered more goods will need to be sold to achieve the original gross margin.

The effect of discounting

	If the present gross margin is:						
	10%	15%	20%	25%	30%	35%	40%
and prices are cut by:	then sales will need to increase by:						
5%	100.0%	50.0%	33.3%	25.0%	20.0%	16.7%	14.3%
6%	150.0%	66.7%	42.9%	31.6%	25.0%	20.7%	17.6%
8%	400.0%	114.3%	66.7%	47.1%	36.4%	29.6%	25.0%
10%	-	200.0%	100.0%	66.7%	50.0%	40.0%	33.3%
12%	-	400.0%	150.0%	92.3%	66.7%	52.2%	42.9%
15%	-	-	300.0%	150.0%	100.0%	75.0%	60.0%

Expense management

Good management of general expenses will contribute to increasing profits. By monitoring organisational expenses, increasing costs can be easily identified and action taken to ensure that the net profit margin is maintained.

When monitoring expenses, it is important to identify the expenditure that keeps the organisation operational and keep these expenses at sustainable levels (e.g. presentation of premises, marketing and staff training).

Continual review of expenses will assist in tracking the movement of expenses. It is important to use the calculations in the "ratios for monitoring profitability" section above as they are the simplest way to quickly see if profits are being eroded. An NFP may wish to consider joining forces with other organisations to benefit from group buying, investigate using companies that allow discounts on bulk orders and always get quotes for different services to ensure that the best possible prices are paid.

Ratios for monitoring profitability

Checklist for managing stock

The following checklist will help determine what measures for stock control may be needed or can be used to improve existing procedures.

1. Review current stock levels and sales volume of stock items

- Determine the current level of stock held and the value of stock.
- Look at sales records to find out which items are good sellers and which are slow moving. Don't forget to look at seasonal trends.
- Work out which items of stock sold have the highest gross margin. This is important as the organisation may then be able to focus more attention on these sales for improved profit.
- Make a list of slow moving, aged and excess stock items and develop a plan to move this stock immediately, even if it is at lower than the cost of the item. This will generate cash to invest in new stock that will move more quickly.
- Update stock records with the current levels and then implement a policy to track all movement of stock. This will help to reorder stock only when it is needed and it will highlight any theft or fraud that may occur.

2. Establish a buying policy

- Identify stock that must always be held in order to maintain sales momentum and ensure that customers are never disappointed.
- Tighten the buying of stock. Knowing the volume sales per stock item will help when carrying stock. Carrying too little stock may discourage customers as the organisation may not be immediately able to satisfy their needs and carrying too much stock means the organisation cash is tied up that could be put to better use.
- Negotiate deals with suppliers but avoid volume-based discounts. When money is tight there is no point investing in next month's stock without good reason. Instead of volume discounts, try to negotiate discounts for prompt settlement (unless the cash position is poor) or negotiate for smaller and more frequent deliveries from suppliers to smooth out cash flows.
- Don't let discount prices drive stock buying decisions. Buy stock that can be sold at a profit in a reasonable timeframe.

3. Identify other areas of the organisation that can impact stock management

- Supplier service can assist in stock management through access to stock only when required and good delivery service. By ordering less more frequently and arranging better delivery schedules stock quantities can be reduced saving valuable cash resources and improving liquidity without reducing sales.
- Advertising and promotion will impact on stock levels. Ensure there is adequate stock or adequate stock can be sourced before launching a promotion. If larger than normal quantities have been purchased make sure a back-up plan is in place if the items don't sell during the promotion.
- Sales policy can also have a strong influence on stock levels and should be managed with a view not just to achieving maximum sales but also to minimise the investment in working capital. This can be achieved by directing policy towards a higher turnover of goods, selling goods bought at bargain prices faster and clearing slow moving items.
- Delivery to customers can impact on stock holdings. By ensuring that the goods are delivered to the customer faster the stock will be moved and the cash for the sale will come in quicker.

Checklist for managing supplier payments and relationships

The following checklist will assist in reviewing what procedures may be needed or can be used to improve existing supplier procedures.

1. Supplier selection

- Decide what is most important thing the supplier can provide the organisation: is it the quality of the goods, reliability, returns policy, price, terms or a combination of these?
- Prepare a list of preferred suppliers.
- Check credit and trade references for each supplier on the list.
- Select suppliers based on the qualities required and the results of the credit and trade checks.
- If one main supplier is chosen be sure that there is an agreement in place with an alternative supplier in case the chosen supplier cannot provide the agreed service at any time.
- Regularly monitor the selected suppliers against the organisation's priorities. As the organisation grows, often the priorities required from suppliers will change.

2. Payment terms

- Negotiate payment terms with suppliers before entering into the transaction.
- Document standard payment terms on each purchase order.
- Calculate the benefit of taking discounts for early payment.
- Ensure that all suppliers are paid on agreed terms, not earlier. Check this on a regular basis.
- Have an agreed process in place in case damaged or unsuitable goods are supplied. Do not withhold payment without letting the supplier know that there is a problem.
- Review the terms with each supplier regularly. If a new supplier can provide better terms, discuss this with the existing supplier before changing over. The existing supplier may be able to match these terms and will appreciate the loyalty the organisation has shown.

3. Maintain creditor relationships (these are just as important as customer relationships)

- Meet regularly with main suppliers to discuss the progress of the organisation (they often may be able to assist with better credit terms, new products etc).
- Ensure that agreed payment terms are adhered to.
- Ensure that suppliers have someone within the organisation that they can contact if they are not paid on time.
- Where payment to a supplier needs to be delayed, advise the supplier and if possible, set up an agreed payment arrangement and make sure it is adhered to. Put the agreement in writing and ensure that the senior finance person or owner receives a copy.
- Be seen as a solid, dependable customer.

Checklist for managing debtors

1. Set up credit controls

- Check the creditworthiness of all potential customers. Have a system in place that documents each credit check to ensure that the process has been properly undertaken.
- Rank all customers by credit risk. To do this, consider the number of years they have been in business, the credit reference from their bank and the credit the bank was prepared to allow them.
- Set a credit limit for the customer in accordance with its credit rating.
- Do regular credit checks on all customers. It is likely that their credit status may change during tough times.
- Make sure that there are systems in place to track any outstanding debts and that the appropriate staff are made aware of it before the next sale.
- Document procedures that need to be undertaken when a debtor exceeds its credit limit and ensure that all relevant staff are aware of them.

2. Establish payment terms

- Include standard payment terms on each invoice.
- Ensure that all staff, including sales representatives, are aware of the payment terms and that they stick to them.
- Implement systems to ensure that all payment terms are met. Send out regular reminders and chase up late payments.
- Have a policy and a process in place for returned goods to ensure that payment is not unduly delayed.

3. Maintain customer relationships

- Meet regularly with customers. Sometimes visiting their premises will help to better understand their business requirements and financial position.
- Review the actual payment with the agreed terms for each customer regularly. If it is identified that a customer is continually paying outside of the agreed terms, meet with them and discuss the issues.
- Ensure that there are processes in place for customers when products or services are not provided as expected (returned goods). Have a policy to cover this type of situation.
- Where an order or delivery is going to be delayed, advise the customer and discuss alternative solutions. Only agree on a completion date for the customer if certain it can be met.
- Be seen as a solid, dependable supplier to customers.

Financial controls checklist - trading

To manage the risk of financial transaction processing failures, manual or automated control procedures should be implemented at key stages of the process.

Some of the questions that can be asked are:

- How well are the financial aspects of the organisation managed?
- Are the organisational operations protecting the organisation against disasters, internal theft and unfavourable external audits?
- How comprehensive are management practices?
- Are the financial records accurate?

Review the following checklist. Organisations with sound financial management practices should answer “yes” to most of the following questions:

1. Sales

	Yes
Is there a policy for credit approval for customers?	
Are credit files kept up-to-date?	
Are credit checks on customers undertaken regularly?	
Are sales orders approved for price, terms, credit and account balance?	
Are all sales orders recorded on pre-numbered forms and are all numbers accounted for?	
Are monthly debtors’ statements reviewed for outstanding balances?	
Is the accounts receivable subsidiary ledger balanced monthly?	
Is an ageing schedule of customers' accounts prepared monthly?	
Are write-offs and other adjustments to customer accounts approved?	

2. Accounts payable

	Yes
Are supplier invoices matched with relevant purchase orders and receiving reports?	
Are all available discounts taken?	
Is there written evidence that invoices have been properly processed before payment?	
Are there procedures which ensure that direct shipments to customers are properly billed to them?	
Is the total of accounts payable reconciled regularly with the general ledger control account?	
Are expense reimbursement requests submitted properly and approved before payment?	

3. Goods received

	Yes
Are supplier's details, including address and bank account details, confirmed with each supplier by a person that is not responsible for paying the suppliers?	
Are all materials inspected for condition and independently counted, measured or weighed when received?	
Are receiving reports prepared and used promptly?	
Are receiving reports: • pre-numbered and is the sequence of all numbers accounted for? • promptly provided to those who perform the purchasing and accounts payable function? • controlled so that liability may be determined for materials received but not yet invoiced?	

Review those questions in the checklist that are applicable to the NFP but for which a "yes" answer has not been provided. Ask management to implement appropriate policies and procedures, including naming the people who will be responsible for them and a completion date. When the appropriate policies and procedures have been set up, a "yes" answer should be possible to all the questions. This checklist should be reviewed annually by the board or management committee.

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