REVIEWING FINANCIAL ACCOUNTS

Okay, so you are a director on a board of a non-profit organisation considering whether to sign off the financial accounts of the organisation, or you may be a member at the AGM and you are looking at the financial statements of the organisation and not sure what they mean.

What questions should you ask of the Auditor?

The Audit Report

Is the Audit Report "Unqualified"?

Unqualified means the Auditor has not placed any qualifications, or disclaimers, in the audit report, such as "except for …." or "subject to ….". Being unqualified means the audit report is 'clean'. It means in the opinion of the Auditor the information in the financial statements fairly reflects the financial performance and position of the organisation.

Management Letter

Was a Management Letter issued?

A management letter provides the Board of Directors with a listing of issues the Auditor felt necessary to bring to the attention of the Board. If there are no issues the management letter should state that there are no issues.

Obviously, a member of the Board is privy to the correspondence. However, there is no reason why a member of the organisation can't ask if a management letter was received and what, if any, issues were raised. It is then up to the Board whether they wish to respond.

Financial Performance

The financial performance of the organisation is detailed in the Profit & Loss Statement, which is sometimes called the Income & Expenditure Statement or Statement of Financial Performance. This statement reflects the income earned, not necessarily received, and the expenditure incurred, but not necessarily paid, during the course of the year.

The Income & Expenditure Statement will also show if the organisation made a Surplus / Profit or a Deficit / Loss during the year.

Review the various line items in the Income & Expenditure Statement for reasonableness. How do they compare with last year? Do they look reasonable to you?

It should be noted that the organisation should be wanting to make a Surplus or Profit. And note, that the word 'Profit' is not a dirty word. Profit allows for the organisation to grow and to allow a flexibility within the organisation to explore efficiency, productivity options, and alternative avenues of success.

Profit also allows you to spend money in areas which sometimes the funding agreement may disallow. For example, marketing and capital improvements are just two areas usually not catered for by grant funding.

So, if an organisation were to make a loss, ask whether this is sustainable. If the organisation has a profit, ask what the organisation will be doing with the additional funds.

Financial Position

The financial position of the organisation is given in the Balance Sheet, sometimes called the Statement of Financial Position. The balance sheet is a statement of the financial worth of the organisation, what assets are owned and what liabilities are owed at the date of the last day of the financial year.

Some typical questions which ought to be considered are:

Is there enough cash to cover the immediate liabilities owing?
Compare the value of cash and bank to the value of the current liabilities.

Are there enough assets to cover all the liabilities?
Compare the current assets to the total liabilities (ignoring at first the non-current assets)? Non-current assets sometimes are overvalued in the financial statements if they have to be sold at a fire-sale auction in a hurry if the organisation is closing.

How self-sufficient is the organisation?
Compare the value of cash to operating expenditure in the income & expenditure statement. The Auditor should be able to work out in terms of weeks how long your cash would last if no income were to come in for a while.

Are all tax liabilities paid up to-date?
Review the balance sheet in the current liabilities area to see what, if any, tax liabilities (eg GST, PAYG, Super) are owing?

Are the employee leave provisions sufficient to cover employee entitlements?
Review the balance sheet to see how much, if any, provisions have been raised for employee entitlements such as annual leave, redundancy, and long service leave. If so, are the amounts reasonable. The Auditor should be able to answer.

Have any contingencies been brought to account?
These may not necessarily have been brought to account in the balance sheet. However, there may be a Note in the financial statements discussing this point. A contingency may be noted due to an unresolved legal dispute, or a matter which may or may not affect the organisation in the future. Ask the Auditor. In this case, the Auditor may refer to the Board who should be more conversant with the issue.

Who can be your Auditor?

An audit can only be undertaken by a person who is independent of the organisation and who can provide their opinion without fear or favour, and who is qualified to the extent required by the relevant Act and by any funding agreement.

Accordingly, the following persons should **<u>not</u>** be your Auditor:

- Any employee or associate of any employee.
- Any director or shareholder or member of the organisation or any associates of them.
- Any person not qualified under the terms of any relevant funding agreement.
- Any person not qualified under the relevant Act under which your organisation is regulated.
- Any independent accountant or bookkeeper who does the primary financial data accounting / bookkeeping or any associates of them.

Greg Farmilo is a Chartered Accountant and Registered Company Auditor and a Registered SMSF Auditor. He is qualified to audit company accounts under ASIC, ORIC, the ACNC and under the Associations Incorporated Act (NSW).

Disclaimer

This guide and the information contained herein, is generic in nature and a summary only and should not be used in any detailed or specific circumstances. We recommend you contact a professional before proceeding.

For more information please feel free to contact us at www.farmilo.com.au

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