



**HAYES KNIGHT**  
Accountancy beyond the numbers

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## Financial Statements and Funding Applications

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### The Issue

Many New Zealand charities are struggling for success with their applications to funding bodies. There is a perceived concern that due to their financial statements showing an operating surplus or having funds in the bank they are not being considered as candidates requiring funding. A similar fear in relation to funding from the general public has been also expressed by charities. This has arisen now that their financial statements will be more publicly available via filing on the Charities Commission website as part of their annual return.

As auditors we see this issue resulting in clients sometimes trying to 'massage' their financial results so they don't appear wealthy. In some cases quite considerable lengths are employed in order to achieve a result of "looking poorer". This generally puts them in direct conflict with following generally accepted accounting practice. In serious cases this can result in a qualified audit report as their financial statements don't fairly reflect their financial performance for the year or financial position at year end.

Competition for the funding dollar in New Zealand is getting increasingly tough. What can a charity do?

### The Enlightened Auditor's Response

Its actually not about the numbers!...a scary statement coming from an accountant. Whether your organisation is rich or poor is actually not the issue. Instead, the fundamental issue is how well your charity is communicating with your stakeholders such as your funding bodies and the general public.

We believe the key messages you want to share through your annual report are:

1. A clear message of why your organisation exists and what it stands for – your reason for being or "raison d'être"
2. Who you help and how – stories, testimonials, and pictures are great here
3. What you set out to do for the year and how you went – this is where some well chosen key performance indicators (KPI's) and reporting against these can be really powerful. Don't over-complicate and don't overload with these. It is a lot more powerful to give a few key ones than to overwhelm people with too many. In our view the ideal is a one page summary.
4. How you govern and manage - who is involved, processes you have put in place, and why this means you are a soundly run organisation. The message you are trying to get across is that funders and donors can trust you with their money
5. What your intentions are – and hence why you need ongoing support so that you can achieve even more as a worthwhile organisation.

This comes from our observations that at a basic level funding bodies primarily want assurance regarding who the organisation is, what it does, why it needs their assistance, and reasons they should have confidence in you.

The simplest way to kick this off is to include a succinct Chairperson's report, or report from the board. This should generally be the first thing in your annual report. Effort into making this easily readable, attractive, informative etc, helps consign the financial statements more to being a "hygiene component" of your annual report, rather than being the main event.

Never underestimate the power of pictures, especially of people and of achievement.

You'll note we talk about your annual report rather than just your financial statements. Most charities have focused primarily on their annual financial statements in the past. They have done this because of history, because they have to prepare these, and because funding providers request them. Please note that we are not saying your financial statements are not important – they are. They need to be accurate, timely, and in accordance with generally accepted accounting practice so readers can easily understand and compare them. However they are often not the most important thing in helping your organisation get your message across to key stakeholders.

Your financial statements are only part of your annual report. The reality is that numbers bore and confuse many people (including, from our experience, some in grant funding bodies). Sad as it may seem to us accountants; numbers are also intrinsically not exciting. (I know; go figure! But there you have it). To tell your story successfully you need to do just that; tell stories. Make it interesting, make it about people, share the struggle, the successes, and what you have yet to achieve in the future.

There are a number of commonly recognised statements that some not-for-profit and public sector entities have prepared in the past to try and better tell their stories. Examples are a "Statement of Objectives and Outcomes" or a "Statement of Community Contribution" or a "Statement of Social Responsibility". These are often best at the front of the financial report with the actual "numbers" pushed further back and possibly summarised and reformatted.

These statements are all in use and worthy. From a marketing or communications view these need to be clear, concise, and interesting to read. It makes them more accessible. You can even play with their titles along the lines of;

- Who we are
- What we do
- This year's successes
- The year ahead and how you can help.

Remember your annual report is fundamentally a communication document and hence needs to communicate to your audiences easily.

## **But we are worried about what our auditor will say?**

The auditor is required to audit your financial statements. They are not generally required to give their audit opinion over any other information within your annual report unless you specifically ask them to. They will however be interested to see and read other information presented in a report alongside audited financial statements. In fact they are bound by an auditing standard that actually requires them to do this. However the purpose is simply to ensure that information presented is not contradictory to the audited financial statements, or to identify another financial statements audit risk that they have been unaware of.

Many entities in the not-for-profit sector are not actually bound to follow generally accepted accounting practice. However most have in the past chosen to comply. We believe this is appropriate as it provides financial information that is widely understood by readers.

This lack of legislative compulsion to comply with generally accepted accounting practice is likely to be addressed in the not too distant future with changes proposed by the Ministry of Economic Development for all registered charities.

Charities are now required, or shortly will be, to post their annual report on the Charities Commission website for public viewing. Given this higher public exposure many charities are now reconsidering what they present to the wider world. In some discussions we have been involved in this has resulted in more summarised financial statements. Often with a note that full financial statements are available on request (but guess what – very few request them). This is really up to you. Your auditor will still audit your full financial statements but you may chose not to present these to all parties.

In our opinion full financial statements are useful and it is generally cost effective just to do one set. However you may wish to keep these as summarised as allowable unless you have a good reason not to. i.e. there is no reason everyone needs to be burdened with how much you spend on telephone expenses unless there is a good reason for disclosing this level of detail.

## **We are trying to build some investment funds for security – how do we show this?**

Many charities are sick of living hand to mouth year to year with all the uncertainty that imposes. As a result we are seeing more charities make a conscious decision to try and build a level of investment funds to:

1. Provide an interest income stream; and
2. Be available as an emergency operating fund should normal funding lines for any reason cease.

We believe this approach is prudent. However it is important that readers of the financial statements clearly understand this strategy and how this demonstrates that the organisation is a prudent well governed organisation, rather than one with excess funds that doesn't need assistance.

We suggest that charities make this situation explicit via a note to their financial statements as to this requirement and the fact it exists for the ongoing stability of the organisation. Clear disclosure generally helps to counter any uninformed concerns from funding bodies or other readers. It also provides an opportunity to be able to highlight the note in discussions with funders.

And that leads me to my last point; if you get the opportunity to talk your annual report with funders or potential funders it is much more powerful than just sending it to them with an application.

If you would like to discuss this further with us please contact:

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