FINANCE FOR ASSOCIATIONS

Financial Literacy for Association Directors

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TABLE OF CONTENTS

1. WHY FINANCE 1

2. FINANCIAL BASICS 1
   - 2.1 Definition of Terms 1
   - 2.2 How Do Associations Do Their Accounting? 2

3. FINANCIAL STATEMENTS, PAGE BY PAGE 4
   - 3.1 The Balance Sheet 4
     - 3.1.1 What Can I Learn from the Balance Sheet? 5
   - 3.2 The Income Statement 5
     - 3.2.1 What Can I Learn from the Income Statement? 6
   - 3.3 The Statement of Cash Flows 8

4. BUDGETS 9

5. YEAR-END 9
   - 5.1 Audit 10
   - 5.2 Review Engagement 11
   - 5.3 Presentation of Statements Without Review or Audit 11
   - 5.4 Audit Committee 12

6. INVESTING 12

7. RATIOS 13
   - 7.1 Growth 13
   - 7.2 Budget to Actual 14

8. IN TROUBLE 14

9. RESOURCES 15

1. WHY FINANCE?

Associations are very different from businesses. The main difference, of course, is that Associations are not-for-profit. While Associations may sell goods and services, those are ancillary to its main function. Although businesses have, for many years, relied substantially or entirely on financial reports to indicate how well they are doing, Associations have always looked at member satisfaction and even social benefit as markers of success.

So, why bother about finance?

It is still important for Associations. If your Association ran out of money, it wouldn't be able to provide member service or anything else. Also, it's important to understand that "not-for-profit" doesn't necessarily mean the Association can't generate a surplus – a surplus may actually be a good idea, as it provides a cushion to allow the organization to invest in new member services and even in things that will expand its member base.

As an Association Director, you are a trustee of the Association's funds. These belong to the members (although, usually, the members will not have any of the money returned to them), and you have a responsibility to conserve funds and use them wisely.

With this in mind, we have prepared this booklet. We are assuming you are reading it because you have had little, if any, exposure to finance before, so we are starting from the ground up.

2. FINANCIAL BASICS

2.1 Definition of Terms

Revenue: this is another word for income. It is the money the Association receives from:

- membership dues,
- Sale of products or services to members and others,
- Event registrations,
- Gains on investments,
- And sponsorships, amongst other things.

Expense: this is the money the Association spends to help it deliver member services and other benefits. Expenses include telephone, printing and postage, rents, salaries, event-related expenditures, and so forth.

You are probably familiar with both those terms from your own personal experience. There are three other terms, however, that may be less familiar to you.

Asset: an asset is something of value the Association owns, usually to help it provide member services. This, of course, includes cash, investments and, some times, accounts receivable (funds owed the Association by individuals or another organization). It may also include office furniture and equipment and, for very large Associations, even vehicles or buildings.

Liability: this is money the Association owes. It includes accounts payable (to trade creditors such as utilities, the telephone company, etc.) and may also include operating loans (similar to a line of credit you may have at your bank), credit card debt, or loans taken to help it finance larger purchases (computers, vehicles, etc.).

Members' Equity: this is also known as net assets, and is basically the difference between assets and liabilities. It should be a positive amount, and represents the maximum amount the Association has available to invest in itself, in new member services, or in other allowable activities.

Members' equity may also be divided into two types – unrestricted and restricted. Restricted members' equity for an Association may arise when a Branch or Chapter folds but, hoping at some future date to be able to revitalize itself, turns its bank balance over to the senior (national or provincial) organization to hold but not to spend. Additionally, some organizations establish scholarship funds and other specially designated funds as restricted equity. Members' equity is unrestricted when it arises from the normal operations of the Association.

Where does members' equity come from? Members' equity is created by the accumulated difference between revenue and expenses. When this is a positive number (a surplus), members' equity increases; when it is negative (a deficit), members' equity decreases. While the occasional deficit may be borne, no Association can go for long without generating a surplus.

All the above can be expressed as equations:

Surplus (deficit) = revenue – expenses
Members' equity = assets – liabilities

The first equation refers to your income, or profit and loss, statement. This statement summarizes financial activity over a period of time (a month, a quarter, or a year, for example).

The second equation reflects the balance sheet. The balance sheet is like a snapshot of what the Association owns and owes as of a given date. The two statements tie together through the members' equity section of the balance sheet, because it will show the current period surplus or deficit from the income statement.

2.2 How Do Associations Do Their Accounting?

The simplest kind of record keeping is the kind you probably already do, if you maintain a cheque record – it is called "cash basis accounting". What it means is that revenue isn't actually revenue until you have it in hand, and an expense isn't an expense until you've written the cheque.

By Canadian law, Associations are generally not permitted to use cash basis accounting (there are exceptions, but we will come to them later). Instead, Associations must keep their books using what is known as "accrual basis" accounting. This means that revenue is generally recognized as revenue when you issue an invoice, and expenses are expenses when you receive an invoice. For most Associations, there is little real difference between the two, because money usually comes in fairly quickly once the invoice is issued, and expenses are paid shortly after the invoice is received. Thus, for most Associations, the only time they need to show

accruals is at year end (or, if they report to members more often, at the end of the reporting period). However, when an invoice (or a group of invoices) represents a significant portion of revenue, they should be accrued as revenue when they are issued.

About those exceptions: small, unincorporated Associations (local sports leagues, etc.) are generally exempt from the requirement to use accrual accounting. However, if the Association is incorporated, it must prepare its statements (at least its published ones) on an accrual basis.

This next isn't really an exception; it's more of a distinction: membership dues. For the vast majority of Associations, membership dues are paid on a voluntary basis. Members belong because they support what the Association stands for, or they like its programs and services, or they like the people, or a host of other reasons. In most instances, however, there is no obligation for them to belong. Thus, when you issue a membership dues notice (or a renewal notice), it is important to recognize it is not an invoice. There are some practical reasons for this. First, while most invoices representing a substantial portion of revenue (e.g. newsletter advertising) should be accrued, issuing membership invoices means the Association is accruing all that revenue; this doesn't give the Board a true picture of the Association's financial health, since the revenue hasn't actually been received. Second, if the Association has registered for GST/HST, it will incur a large tax liability at a time when revenues are typically low, and this may cause financial hardship. It also complicates things at year end, when an adjustment has to be made for non-renewed members.

One other note on accruals – many Associations will not accrue certain invoices as accounts receivable because of the risk of non-payment or very late payment.

What About Accruals at Year-End?

At the end of the Association's financial year, the situation regarding accrued items becomes a little different.

Assets

Any uncollected invoices at year-end should be accrued to revenue. This might be for advertising in the Association's magazine or newsletter, or on its website; or sponsorships, etc. Interest income or gains on investments should also be accrued to revenue, as it reflects money earned by the Association during the year that it typically doesn't see as actual cash. Finally, prepaid items (typically insurance, but possibly also rent, lease payments, and so forth) are accrued – these items often have the effect of reducing expenses.

Liabilities

Expenses for which invoices have not been received are often a significant accrued expense, and would appear as such on the balance sheet. Sometimes, an interest expense may have been incurred but not paid; this should also be accrued as a liability. In both these cases, in addition to being set up on the balance sheet, they also appear as expenses on the income statement.

For Associations that send out membership notices ahead of the fiscal year end (a good idea, by the way), they may be in receipt of dues payments made before the

year-end. Because these are paid in respect of the next membership year, they cannot be shown as income at the "current" year-end. Instead, they appear on the balance sheet as deferred revenue. Any other funds paid to the Association in respect of the next year are also considered deferred revenue. This might be a prepayment for a year's advertising on the website or in the magazine/newsletter, prepaid tuition for courses or seminars, and so forth. Once the Association's books move to the next year, these items will be taken into revenue.

3. FINANCIAL STATEMENTS, PAGE BY PAGE

You can have a very simple presentation of your Association's financial statements – one that shows only the current year-to-date activity. This is fine as far as it goes, but it doesn't give you, as a Director, much information. There are a number of questions you could ask, but they all boil down to "Are we doing well?" Statements giving you only current data don't answer those questions fully.

You could include other information in your statements:

- Current month (to date): this lets you know the situation in the current month. This might be important, for example, when you are in a month in which revenues are low (particularly at the beginning or end of your fiscal year)
- Previous year-to-date: this means you have figures for this same time in the previous year, and is very valuable, as it shows how this year's results compare to the previous year. You can spot items that are both higher and lower than the prior year, and ask for an explanation of the difference (known as a "variance" in financial circles)
- Previous year-end: this is particularly useful if you have previous year-to-date figures, because it can help you get a feel for whether, based on historical trends, you can expect much more by way of both revenues and expenses
- Budget: even if you don't have the above information in your statements, you should have budget figures. They allow you to ask about significant variances that may exist between current results and the Association's financial plan

Ideally, of course, you should have all the above information on your financial statements, and specifically on your income statement; it is not so relevant on a balance sheet. We'll come back to this later on, and discuss how you can use the information.

3.1 The Balance Sheet

Often, the first statement you will see in the financial package you receive from your Treasurer or staff is the balance sheet. Remember, this shows what the Association owns, what owes, and what the difference between the two is.

Your balance sheet should have at least three categories:

- Assets: what the Association owns
- Liabilities: what the Association owes
- Members' Equity (or net assets): the difference between the two and, theoretically, what the members own

However, there are some subdivisions for the first two categories that may crop up in larger Associations:

- Current Assets: these are items that can reasonably be expected to be converted to cash in the coming year. They include cash itself (or "bank", or the specific name of the bank the Association uses), accounts receivable, short term investments, inventory (goods held for resale, such as course manuals or texts, other Association publications, etc.) and prepaid expenses
- Fixed Assets: these are things that will take more than a year to "convert" to cash (convert is in quotes because, in most cases, they don't convert directly to cash at all, unlike current assets, which almost always become cash). If the Association owns buildings, computers, vehicles, etc., they will appear here, along with any longer-term investments
- Current Liabilities: as you would expect, these are items that will be paid in the coming year. They include accounts payable, any line of credit the Association may have, deferred revenue and the portion of any long-term debt scheduled to be paid in the current year
- Long-term Liabilities: these are liabilities the Association expects will take more than a year to pay. These might be mortgages, other loans made against property such as vehicles, and, in some instances, leases

On the members' equity side, we've already talked about restricted and unrestricted equity. However, the members' equity area of the balance sheet will also show the surplus or deficit for the current year-to-date. This is added to the "opening" members' equity to give total members' equity at the end of the period for which statements have been prepared.

Ideally, total assets will be higher than total liabilities, and the financial result year-to-date will be a surplus, so the members will have some equity.

3.1.1 What Can I Learn from the Balance Sheet?

The balance sheet by itself will give you an idea of how much money the Association will have in order to meet its liabilities (by looking at cash (or bank, or whatever your Association calls it) plus accounts receivable). It can also show you where the Association is investing excess funds (and, if you have a previous year figure, whether that investment is growing or not; this tells you whether it's a good use of those funds). It will give you an indication of how much money is tied up in inventory, accounts receivable (basically, Association money being used by customers or members) and accounts payable (how much of your suppliers' money you are using).

As useful as this information is, it's only part of the story. When you use the balance sheet in conjunction with the income statement, you can learn a lot more.

3.2 The Income Statement

This is where comparative information comes in really handy. But, before we get to that, let's look at the structure of the income statement.

- Revenue: this is money the Association received during the period (usually, year-to-date). To be really helpful, this number should be broken down to

show the various sources of revenue (membership, events, product sales, etc.)

- Expenses: this is the money the Association has spent to earn the revenue shown at the top of the statement. It, too, should be broken down by category
- Surplus or Deficit: revenues less expenses; hopefully this number will be positive (a surplus)

If your Association is a larger one, or has complex operations, there may be additional pages in your financial package; these would show further detail on individual income and expense centres.

For instance, there might be a page on memberships, showing revenue from different member classes (if you have them) and members who pay different rates (such as retired or student members). This information tells you not only whether total membership is growing, but whether it is growing for each class of member. In reading this, of course, you need to be aware of the effect of any increase or decrease in membership dues. On the expense side, you might show a cost for printing and mailing renewal notices, plus any other relevant costs, as "membership expense".

If you publish a magazine or newsletter and sell advertising in it, you might want to have a page showing revenue and expense by issue. For events such as workshops, seminars, lunch-n-learns, information breakfasts, dinner meetings, and so forth, you may find an events page, showing revenue and expense for each type of event, or even for each event, is helpful. You can get into as much detail as you choose with your statements (assuming, of course, your Treasurer agrees and the situation warrants it). If you present a major annual conference, it is definitely a good idea for it to have its own income statement, although a balance sheet is neither workable nor necessary.

All the figures on these extra pages also appear on the main, or consolidated, income statement.

3.2.1 What Can I Learn from the Income Statement?

There are two different levels of analysis. The first might be called "at a glance". The second is detailed and calculation oriented.

At a glance, you can compare the current year-to-date with the prior year-to-date, and ask questions about both variances (why one is different from the other) and trends (if items are higher or lower than the prior year, does this represent a trend?). Doing this will help you flag areas that do not reflect the Association's history.

If you have budget numbers (and, as mentioned above, you should at least have budget numbers), you can also compare current performance to the budget. Is the Association achieving its financial plan? Are we above the projection (or below it)? And, no matter the answer to those questions, the next question is always "why?" It is important to account for variances to budget – where results are below the budget, you need to know why so corrective action can be taken; if results are above of budget, you need to understand the reasons in case there is something the Association can learn and apply.

Where the Treasurer supplies current month figures, this allows you, in conjunction with the balance sheet, to look at whether there will be enough revenue in a low-revenue month and subsequent months to meet expenses. Some Associations have the ability to borrow from a financial institution, and this gives you an idea of whether that will be necessary. In addition, after you have been on the Board for some time, you will have a better picture of how cash flows through the Association; this gives you even better background on the potential need to borrow, and the value and risk associated with locked-in versus liquid investments (a liquid investment is one that can easily, and perhaps even immediately, be cashed; a locked-in investment, also called an illiquid investment, usually has provisions that either don't allow cashing it for a set period of time, or permitting it within the period, but specifying a penalty). This information is all very helpful for cash management.

Detailed analysis is, as noted above, calculation oriented. We won't go into a great deal of detail on this, but there are a couple of calculations it's worthwhile to consider.

The first is called "vertical analysis". You look at everything as a percentage of total revenue. If your statements give you a breakdown of revenues, you can calculate each category as a percentage of total revenue. Similarly, with expenses, you can calculate them as a percentage of revenues. Finally, you can do the same for the surplus or deficit. The sum of all revenues categories is 100%; likewise, expenses and surplus/deficit will total 100%. The formula is simple:

Take the revenue or expense category you're looking at, divide it by total revenue, and multiply the resulting number by 100. As an actual equation, it looks like this:

$$\left(\frac{category}{revenue}\right) \times 100$$

This can be done on a month-to-month basis, or based on year-ends. When you compare different years on this basis, you can get some idea of what trends may be affecting the Association. This is particularly good when it comes to looking at expenses. You can, if you want, get into even more detail by looking at the additional pages your Treasurer supplies and doing the same calculation (except you would only use the revenue generated by that one category). Where this is less helpful is what we've called "expense centres" – areas where a lot of detail is useful, but there is no revenue to use as a base figure. In this instance, you can calculate each expense line as a percentage of the total expense for that category.

As an example, take an Association that takes in $100,000 in total revenue, of which $55,000 is membership renewals. The equation will be:

$$\left(\frac{55{,}000}{100{,}000}\right) \times 100 = 55\%$$

Another calculation you may wish to look at is growth in key areas. Usually, these would be total revenues, surplus, and both total and net assets. In order to do this,

you will need two or three years (at least) of financial statements. Unlike the vertical analysis, there are only four sets of numbers of concern. The year that is longest ago is your base year. If you're doing the math for 2017, and you have information going back to 2010, then 2010 is your base year. The formula is a little more difficult this time:

Subtract 2010 revenue from 2017 revenue; divide that number by 2010 revenue, and multiply the result by 100 (so everything is expressed in percentages).

$$\left(\frac{2017-2010}{2010}\right)\times 100$$

You would do this for each of the four categories (revenue, surplus, total assets and net assets) for 2017 (2017 is the year you're analyzing, and 2010 is the base year, so the equation becomes the 2017 figure minus the 2010 figure, with that number divided by the 2011 figure, and <u>that</u> number multiplied by 100). This shows you, year over year, what the changes for each of these major numbers are, and allows you to ask what accounts for those changes.

For example take an Association that had total 2017 revenues of $160,000 and 2010 revenues of $100,000. The equation would then be:

$$\left(\frac{160{,}000-100{,}000}{100{,}000}\right)\times 100 = 60\%$$

There are, of course, a great many other analyses you can do, but these will be enough to help you ask intelligent questions of the Treasurer.

3.3 The Statement of Cash Flows

For the most part, unless your Association is extremely large, you will only see this statement as part of your year-end audited financial statements. Like the income statement, it summarizes certain activities that have taken place over a period of time. These activities are called:

- <u>Cash flow from operations:</u> this essentially takes the income statement and converts it to a cash basis. As such, it only considers actual cash received (from sales of memberships, workshops, etc; interest or dividends on investments) and deducts actual payments made (to suppliers, employees and interest payments on loans), and expense items that were not cash in the first place, such as depreciation or amortization (if you have fixed assets)
- <u>Cash flow from investing activities:</u> this includes cash on which the Association expects some sort of a return. Typical items are receivables (perhaps for sponsorships, advertising on the website or in a publication, etc.), purchase of fixed assets or payments related to mergers or acquisitions (Associations <u>do</u> merge from time to time)
- <u>Cash flow from financing activities:</u> most items in this category reflect the activity of a business rather than an Association – things like dividends paid, stock repurchased, funds received from investors and net borrowings – but an Association would look at increases in accounts payable, prepaid expenses, etc.

Given the description above, you can see why the statement is seldom prepared. It is required as part of an audit or review, but, since Associations tend to be cash organizations, the totals are relatively small. What this statement shows you is "where the money went (or came from)" – it balances the audit year's opening cash balance with its closing cash balance.

4. BUDGETS

A budget, as we said above, is the Association's plan for the year. It should not be the only plan, but will be the financial reflection of all the other plans. Your Board should devote a meeting to setting the budget.

The draft you see may be the work of the Treasurer, the work of staff, or the combined efforts of both. Ideally, if you have staff, it will be a combined effort. A good budget will show the current year-to-date financial results along with at least two previous years. If your financial statements have detail pages, the draft budget should have the same level of detail with the same comparatives.

A better budget will include (in addition to the comparative information discussed above) assumptions for the revenue and expense estimates, showing the number of members by category, or estimated attendance at events, along with registration fees, room and food cost, etc. (details will obviously be appropriate to the income statement category). This information will allow you to evaluate the budget more effectively.

When reviewing the assumptions, consider whether they are reasonable. For instance, if the budget calls for a tripling of event revenues with no similar increase in marketing and promotion, you may want to ask how those attendees will be attracted. Be aware of revenues that are projected to be unrealistically high and expenses that are projected to be either unrealistically high or unreasonably low. This is where the underlying assumptions can be of assistance, as they allow you to see the source of the numbers.

In short, the Treasurer and/or staff should have a reason for every number in the budget, and should be ready to defend them all. If that is not the case, the Board must collectively come up with a reasoned number on which everyone can agree. Bear in mind that the budget is the yardstick by which your success as a financial trustee for the members will be gauged, so coming up with a sound budget is well worth the time and effort.

5. YEAR-END

The end of the year will start some processes going. Financially, an Association will do one of three things at the end of the fiscal year:

- Have an audit of the books: an audit is carried out by a practicing accountant who is qualified (has received appropriate training) to conduct one. It is the most rigorous process, but arguably provides the most reassurance to members
- Have a review engagement: a review engagement is more limited than an audit, and therefore less rigorous. It is still conducted by a properly qualified

accountant but, as the notice that usually accompanies it warns, it may not be appropriate for all users
- Present statements without review or audit: this is neither rigorous nor costly, but is the most risky. However, some very small Associations may be able to get away with this because they lack funds

In deciding which of the above to do, your Association should consider the laws of the jurisdiction in which it is incorporated as well as its ability to pay the necessary cost and the needs of the members and other users of the statements. For example, an Association incorporated federally is required to have an audit if total revenues exceed $1 million. If the Association has a line of credit, part of the loan agreement with the financial institution may specify that an audit be conducted annually. In some instances, where the Association receives a large amount of government funding, it may also be required by the government to provide audited statements (this will be spelled out in an agreement). Finally, an Association that is also a charity may have to undergo an audit if its donation and total income meet particular thresholds.

5.1 Audit

In an audit, the auditor will examine several things and present an opinion on them. Technically, the audit consists only of that opinion, and not the statements; the statements can be said to have been audited, but they are not the audit.

The primary part of the audit is the auditor's opinion on whether the Association's accounts have been kept in accordance with generally accepted accounting principles (GAAP), and whether they fairly represent the financial state of the Association and are free of material misstatements.

The auditor will look at the financial records, comparing entries in the books with source documents (invoices, deposit books, cheque stubs, etc.). S/he will likely contact the Association's bank, asking them to confirm the year-end balance. If the Association has a small number of organizations that are a significant source of funds (this would include suppliers), the auditor may also contact them to confirm the credit they have provided the Association during the year. If this is all in order, the auditor is able to say the books are free of material misstatements.

The auditor then looks to see that the books have been kept in accordance with GAAP. There are a number of issues s/he will need to consider (there are some 30 standards that, depending on circumstances, apply to Associations), and there are tests s/he will apply. A couple of very common examples are:

- Was revenue that was earned in the year actually recorded then (this helps ensure that revenue from a subsequent year wasn't shown for the audit year to make the statements look better)?
- Were the expenses that were incurred to earn the revenue also recorded in the year (this helps ensure that expenses from the audit year weren't deferred to a later year to make the statements look better)?

Next, the auditor looks at internal financial controls. This is a legacy of the financial scandals of the late 1990s. It is not the auditor's job to check for fraud, but, in looking at internal financial controls, s/he does test to see whether the Association's management would be able to catch fraud.

If all of the above points are to the auditor's satisfaction, the Association will receive an unqualified audit opinion (the other kinds of opinion are qualified – the auditor has concerns about an item in the statements, but feels management has been honest; disclaimer – the auditor declines to express an opinion on a particular element of the financial statements; and adverse – the auditor says the statements are misleading or incomplete in a material way).

Three other areas on which the auditor will express an opinion are whether the Association is able to continue operating as a going concern; what financial risks may be associated with the Association's financial instruments (loans, accounts receivable, investments, etc.) and whether the Association has recognized those risks in valuing the instruments; and the quality of any estimates made by management, to see if these are reasonable. The auditor will also make a number of additional notes to the financial statements to indicate the tests s/he performed or areas at which s/he looked.

5.2 Review Engagement

In a review engagement, the accountant looks to see if the Association has kept its books in accordance with GAAP, and whether management estimates are plausible. It is much less extensive than an audit, but still contains some testing and provides some reassurance to the members (and any others) who use the statements.

In a review engagement, the accountant will express an opinion on the above two issues, basically rolled into one (adherence to GAAP). In an unqualified opinion, s/he will say that the statements have been prepared in accordance with generally accepted standards (or GAAP, depending on the Association and accountant). In an adverse opinion, the accountant will state GAAP has not been followed.

In all review opinions, the account will clearly state that s/he did not perform an audit and therefor does not express an audit opinion.

5.3 Presentation of Statements Without Review or Audit

If an accountant compiles the statements, this is called a "compilation" or "notice to reader" engagement. The accountant simply works with what you have given him/her, including estimates and other information, but does absolutely no testing of any kind.

The covering letter to the statements states that the accountant has performed neither an audit nor a review and expresses no opinion on the fairness or accuracy of the statements. S/he will go on to caution readers that the statements may not be appropriate for their use.

If the statements are compiled by an in-house accountant, and particularly one who does not hold a recognized accounting designation, there should be a notice to that effect, along with the fact that no tests have been performed to ensure adherence to GAAP.

Bear in mind that the compiled statements provide the least security to members and others – essentially, they must take your word that the statements are accurate and based on "good" information.

5.4 Audit Committee

Some Associations will have an Audit Committee, whose job it is to determine what accounting policies should be applied in developing the statements and management estimates, and to supervise the auditor while s/he conducts the engagement. The Audit Committee should also review the statements and any other information provided to members (essentially in the form of an annual report, which many Associations do not issue). Typically, only very large Associations will have an audit committee, although it is considered good practice to do so. If your Association has, or is considering, appointing an Audit Committee, the major concern is all its members must be financially literate (beyond what is in this guide).

6. INVESTING

If your Association has a large amount of excess cash that won't be required to finance operations for a year or more, you might want to consider investing it since, usually, Association funds in a chequing account earn little, if any, interest. When doing so, remember that you are in a fiduciary position for the Association when it comes to cash, and are accountable to the members if the money is lost. Your accountant or an investment advisor can advise you on this topic but, to get you started, here are some investments we would and would not recommend:

- Federal or Provincial bonds: These investments are generally very safe; the trade-off is they do not pay as much interest as other options. However, they are recommended.
- Bank investment accounts: most banks have accounts in which you can invest and which pay better interest rates than an ordinary savings account. All bank accounts are guaranteed by the Canada Deposit Insurance Corporation (CDIC) up to a maximum of $100,000[1]. This is a recommended investment
- Guaranteed Investment Certificates or term deposits: Most (but not all) of these lock your money in for a year or more, so if you plan on putting most of your cash into one, consider that it is relatively illiquid (not easily converted to cash on short notice). That said, any GIC or term deposit with an original term 5 years or less is insured by the CDIC (again, up to $100,000). Subject to that caveat, this is a recommended investment
- Bonds of a large bank, insurer or industrial company: In Canada, banks and insurance companies are *generally* safe investments, as there have been relatively few failures in the last century or so. These are not as desirable as government bonds but are a possibility if you are careful. As we all learned with Chrysler and General Motors, even the largest industrial company can run into trouble, and, because of the risk, this type of investment is not recommended
- Mutual funds: a mutual fund is a "safer" way to invest in stocks, bonds, mortgages and other instruments, because the fund buys shares in a spread of investments, and has professional management whose job is to watch the various investments and investment markets, and move the fund's money

[1] CDIC insures chequing and savings accounts, term deposits whose original maturity is in no more than 5 years and certain financial instruments denominated in Canadian dollars at member institutions, to a maximum of $100,000 per account type **per institution**. Thus, if the Association has two chequing accounts at different branches of the same bank (or both at the same branch), the maximum insured amount would be $100,000 or whatever the balance is, whichever is less. This insurance protects you in the event the institution fails.

around to get the best return for investors. Safer, however, does not mean risk-free. While most mutual funds offer insurance on the principal amount (the original investment plus any additional investments over the years), there is no guarantee on whatever gains you may have made. Therefore, this is not a recommended investment

- Stocks: investing in stocks, no matter how "gilt edged", is not a field for Associations. The market is too volatile, and the time required to do a good job at it is beyond what most Associations or their staffs have available. In addition, your investment is not spread among a large list of stocks as it would be with a mutual fund. Finally, there is absolutely no insurance for this activity. This investment is most definitely not recommended

In evaluating investment opportunities, remember you have a fiduciary responsibility to the Association to make the best use of its assets, and a duty of care to investigate all options carefully. In this instance, "best use of assets" requires you to balance the safety of the potential investment against its potential return. Because it is not your personal money, "safety" should always win. The return on the investment comes into play when you are considering two investments of equal safety. Remember, however, that the safer an investment is, the lower its return.

Depending on your Association's financial position, you may want at least a portion of your invested funds to be easily and quickly convertible to cash; your chosen investment should provide a reasonable degree of liquidity. Normally, the safest investments are the least liquid, although some banks have products that allow conversion to cash.

7. RATIOS

A ratio compares one thing to another. It might be expressed as a percentage or as [x]:1. There are a great many ratios in finance; earlier in this booklet, when we were discussing the income statement, we presented two ratios, one of which looked at expenses and individual revenue items as a percentage of total revenues, and one that looked at growth in various items over time. The math in ratios is fairly easy. Where it can get interesting is in determining what the ratios mean.

Traditional business finance texts (and courses) will give you in-depth explanations of the calculations and meanings of many ratios, but not all are relevant for the average Association (by which we mean an Association that is relatively financially healthy – we'll discuss the other kind in the next section).

7.1 Growth

Growth ratios were discussed earlier. We suggest you look at year over year changes (growth, hopefully) in total revenues, surplus, total assets and net assets (members' equity).

Ideally, do this for a number of years, and look at the trend. You should see a general upward trend in these numbers, even if some years show shrinkage. However, the general direction of the trend is also important. If the growth rates stay relatively constant, or decrease each year, it's a sign the Association may be in for some tough times, and corrective action may be required.

One of the issues with growth calculations is you are always using what are called "current dollars" – that is, dollars that have not been adjusted for the effects of inflation. This is not as important an issue as it was in the late 1970s and early 1980s, but comparing your growth rates to the growth in inflation gives some context. If inflation between this year and last is 2% and your growth in revenues was 1.5%, you are actually losing ground. You can find inflation figures for Canada at http://www.rateinflation.com/inflation-rate/canada-historical-inflation-rate.php (just enter the first and last year for which you want numbers, and click "Get Data". If you look at the month in which you have your year-end, you can compare it with the same month in the previous year and see the inflation rates).

7.2 Budget to Actual

Another "ratio" that should be provided to you in your financial statements is a budget to actual comparison. Normally, this is presented in dollars, and assuming you are using year-end figures, that is fine to give you a rough sense of how the Association is doing. To really mine this data, though, it's useful to look at actual results in comparison with the budget, using percentages. For the most part, this means looking only at the year-end results, as they are most complete.

We recommend two calculations – the vertical analysis (discussed earlier) can be done for both actual expenses and the budget – this may help identify expenses that were budgeted too low or too high, and enable corrective action. The other calculation is a variation on the vertical analysis, except you compare actual results to budget, and express it as a percentage. Here's the formula:

$$\left(\frac{actual\$}{budget\$}\right)\times 100$$

If you do these analyses over a period of years, they will show any consistent problems with budgeting. A caution, though: do not be quick to blame the budget process (or the person who draws up the draft budget) itself without looking at other contributing factors – were initiatives planned for the year that were not carried out? Did an unanticipated external event (a recession, for example) affect the results? Did another Association or a commercial organization come up with a better offer (membership pricing, competitive product or service)? Make sure you have the full picture before making judgments.

8. IN TROUBLE

No one wants this to happen, but it sometimes does – your Association is experiencing difficulties, and is incurring deficits for several years running, or a single, very large, deficit. The key question becomes, what do you, as a Board, do?

The most important thing is to discover what is causing the problem. There are several possible culprits:

- Revenue is down because:
    - Memberships (both new and renewed) are lower than expected
    - Revenues generated by other products/services (seminars/workshops, conference, books, etc.) are down

- Expenses are higher than anticipated because internal financial controls are poor. In this instance, we are not talking about controls to prevent fraud or identify poor bookkeeping/accounting practices (although this is always a possibility, and should be explored). What we are referring to are controls that ensure expenses are kept within the budget, and that variances are accounted for
- Expenses were higher than anticipated because there was an unforeseen cost (this might be an initiative the Board decided to take on mid-year, or a reassessment of taxes that results in an increased tax liability)
- The budget itself was over-optimistic and overstated revenue or understated expenses (or both). This may be the case if the budget forecast a surplus or a very small deficit, and a large deficit was incurred

Obviously, this is not an exhaustive list, but it does provide some easy areas for investigation. If you have not already done the trend analysis suggested above, now is the time. The budget to actual analysis may also be helpful. Give some consideration to studying your market(s) for each product/service, including membership. Discover the trends that may be affecting revenues for each of the Association's offerings. If the budget provides detailed assumptions, review them to ensure they are realistic. If the budget does not give that level of detail, it's time to start. In either case, do a budget revision and a "balance-of-year" estimate

The worst thing you can do is to take action without understanding what has gone wrong. In actual fact, that is a panic reaction rather than action. We also suggest you avoid curtailing marketing expenditures. You should, however, ensure the funds you spend on marketing are being spent well. This again comes down to understanding the market – not just trends, but who customers/members are, what they buy, and how and why they buy it. There are many good marketing resources, on-line and in print, that can help you here.

9. RESOURCES

Watch our website, www.Associationconcepts.ca, for more resources in these areas. Because of the importance of finance to an organization, consider enrolling all Directors in a basic finance course (not a bookkeeping course). Also, an on-line search on "Association finance" will turn up some useful resources.

Good luck!