Amplifying Our Voice: Leading Boldly for Our Students, Our Professions, and Our Union

How to Read Financial Statements, Audits, and Budgets Like a Pro

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COMPETENCY: STRATEGY AND FISCAL HEALTH

• NEA Leadership Competency progression level:
  • Level 1: Foundational

• NEA Leadership Competency themes:
  • Supports fiscal health
NEA Strategic Goal and NEA Organizational Priority:

• NEA Strategic Goal
  • Building the capacity of the local, state and national union to ensure the success of public education

• NEA Organizational Priorities
  • Supporting Professional Excellence
Tone at the Top and Fiduciary Responsibilities
Tone at the Top

• An association’s leadership creates the “Tone at the Top” – an ethical (or unethical) atmosphere in the association

• The tone of the leaders and management has a trickle-down effect on others

• The officers, board of directors, and management are responsible for setting the proper tone
What are my General Fiduciary Responsibilities?

• Act in the best interest of the association
• Use good faith and honesty when making decisions
• Exercise all of the skill, care and diligence that a prudent person would exercise when acting on behalf of the association
• The board should strive to make the best or right decisions in all situations
Are you.....

....a prudent person?
Act as a Prudent Person

Acting as a prudent person requires:

• Attendance
• Inquiry
• Skill
• Caution
• Use of best judgment
• Reliance on experts (as necessary)
Board Member’s Fiduciary Responsibilities

As a board member it is your responsibility to:

• Remain independent

• Maintain strong ethical values
Board Member’s Fiduciary Responsibilities (cont.)

As a board member it is your responsibility to exercise:

• Duty of Care – act with care, diligence, good judgment, and with wisdom in all decision-making responsibilities

• Duty of Loyalty – act in the best interests of the association
  • Avoid conflicts of interest
  • Executive session matters and decisions remain confidential
Board Member’s Fiduciary Responsibilities (cont.)

As a board member it is your responsibility to exercise:

• Duty of Obedience – act in the best interests of the mission of the association

• Duty of Good Faith – act honestly, conscientiously, and fairly
Board Member’s Responsibilities

As a board member it is your responsibility to:

• **Safeguard** the assets of the association

• **Protect** the image, reputation and credibility of the association
Board Member’s Responsibilities (cont.)

As a board member it is your responsibility to:

• **Ensure** the resources of the association are utilized to the maximum benefit of the members

• **Preserve** the tax exempt status of the association
Questions? Ideas?
Fraud and Internal Controls
Is $50,000 a lot of money for your association?
What is Fraud?

Any intentional act or omission designed to deceive others, resulting in the victim suffering a loss and/or the perpetrator achieving a gain.

Managing the Business Risk of Fraud: A Practical Guide prepared by IIA, AICPA, and ACFE
The Fraud Triangle
Understanding the Fraud Triangle

• **Pressure** – Usually caused by financial need or desire for lavish lifestyle

• **Ability to rationalize** - Justification of dishonest actions
  • The “borrowing” approach

• **Opportunity** – Typically arises from:
  • Lack of internal controls
  • Abuse of authority
  • Leaders overriding internal controls
Profile of a Fraudster

- Male
- Regularly attends church
- Serves in a position of trust and authority
- Long-time trusted volunteer
- Between the age of 36-45 for females and 56-60 for males
- Highly educated
Behavioral Red Flags

- Living beyond means
- Financial difficulties
- Unusually close relationship with a vendor/customer
- Excessive control issues or unwilling to share duties
- Recent divorce or family problems
- “Wheeler Dealer” attitude ~ unscrupulous behavior
Fraud Red Flags

Not everything that looks suspicious is a fraud, but every fraud looks suspicious. If it looks suspicious, follow up on it!
# Effectiveness of Anti-Fraud Controls

| Source: ACFE Report to the Nations |

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Internal Controls Are Not Personal

Internal controls are not a matter of “we don’t trust you.” Internal controls are a matter of this is good business practice to protect our members’ money

Do not take internal controls as a personal affront

Internal controls build a better association
Types of Internal Controls

Preventive

• Let’s stop unwanted outcome before it happens
• Prevents occurrence of unwanted outcome in a proactive manner

Detective

• Let’s find the problem before it grows
• Detects the occurrence of an unwanted outcome in a reactive manner
The Board Member as an Internal Control

• Adhere to Code of Conduct
• Read:
  • Financial statements
  • Audit reports
  • IRS Form 990
  • Other documents provided
• Adhere to Conflict of Interest and Whistleblower Policies
• Attend financial trainings
Questions? Ideas?
Understanding Financial Statements
For Consideration

Are you and the board of directors receiving monthly financial statements?
For Consideration

Are you reviewing the financial statements on a monthly basis?
Fulfilling Your Financial Role

• You are not expected to be an accountant

• Understand the financial picture of your association – including related parties, if any
Fulfilling Your Financial Role (cont.)

• It is essential that you are a financial inquisitor (prudent person) so ask questions----ask lots of them!

• Establish and monitor key financial indicators
  • General guidelines and standards to measure effectiveness
  • Use proper tools to monitor financial performance and policies to guide decision-making
There Are No Excuses....

• How could anyone expect me to know?

• I trusted the treasurer, the finance staff and experts!

• Why didn’t someone tell me?
Financial Reporting to the Board

• The board’s role includes review of interim and year-end financial statements in order to:
  • Manage resources
  • Question and evaluate results
  • Look at the big picture
  • Detect fraud – act as an internal control
  • Fulfill fiduciary responsibilities

• In order to fulfill this role, the board must receive accurate and timely financial information
Financial Reporting to the Board

From financial statements, the board should be able to:

• **Determine if cash flow is adequate** to meet the immediate and future needs of the association

• **Make informed decisions about the direction of the association** and any immediate actions that need to be taken to continue operations and segments of operations

• **Analyze the actual position of the association** compared to the budgeted numbers
Financial Reporting to the Board (cont.)

From financial statements, the board should be able to:

• **Make recommendations and take action**, if necessary, based on these reports

• **Determine that financial records are maintained on a timely basis**
Need to Have Financial Information

• Statement of Activities aka
  • Income Statement
  • Profit and Loss Statement

• Statement of Financial Position aka
  • Balance Sheet

• All bank account balances
• All investment account balances
• The check register
Need to Know Financial Information

• Post-retirement benefit plans and related obligations
• Net asset account balances
• Working capital – current assets (less) current liabilities
• Land, Building, Equipment – age of infrastructure, value of building and land
• Terms and maturity date of long-term debt
Financial Statements Must Be Transparent

- Relevant
- Reliable information
- Complete information
- Accurate information
- No surprises!
The Financial Statements Need to be Timely and Relevant

If you are not receiving the financial statements in a timely manner then the information contained within them is no longer relevant.

You simply cannot make wise association decisions if the financial information is no longer current.
Principle of Materiality

Would the omission or misstatement of accounting information influence the judgment of a reasonable person?

• Not limited to just dollar impact – information as well
Seasonality

Regular and predictable changes that occur each year

• Dues
  • 9/10/11/12 month payers
  • Cash, receivables, deferred revenue

• Delegate/representative assembly expenses
  • Spring/early summer
Cash Basis and Accrual Basis Accounting

Financial statements are presented in either a cash basis or an accrual basis of accounting

• Cash Basis – Revenue is recorded when payment is received and expense is recorded when payment is made (Department of Labor Reporting)

  ▪ Accrual Basis Accounting – Revenue is recorded when it is earned and expense is recorded when the obligation is incurred (Generally Accepted Accounting Principles - GAAP)
Understand the Statement of Financial Position

• The Statement of Financial Position (AKA The Balance Sheet) = Where we are now

• Measures the association’s assets and liabilities for a point in time

• Reflects the cumulative effect of operations over the lifetime of the association (Net Assets)
Assets = Liabilities + Net Assets

Total assets (A)
ALWAYS EQUAL
Total liabilities + Net assets (B)
Current Assets and Liabilities

• **Current assets** are assets that will be converted into cash, depleted or sold within a business cycle – typically 12 months – highly liquid (C)

• **Current liabilities** are those obligations due within a business cycle – typically 12 months (D)
Long-term Assets and Liabilities

• Long-term assets are assets that cannot be converted readily into cash (E)

• Long-term liabilities are liabilities that mature longer than one business cycle (F)
Understand the Statement of Activities

• Statement of Activities (the Income Statement) = *How we are doing*

• Shows the results of operations for *a specific period of time*

• Typically a 12 month period
  • Calendar year end
  • Fiscal year end
The Statement of Activities

• Total revenue (1)

• Total expenses (2)

• Change in Net Assets (3)
  • “Non-profit accounting speak” for net income or net loss
  • Might also see “Net Surplus” or “Net Deficit”
Comparative Data is Essential

• Financial statements
  • Prior periods or years
  • Current budget
  • Projections

• Proposed budget
  • Current year and prior year(s) budget
  • Prior year(s) actual financial information
  • Current year-to-date financial information
  • Projected year-end financial performance
  • Projected future year(s) financial performance
How To Be Successful With Reading Financial Information Like a Pro

1. Read the financial statements – use The 8 Easy Steps
2. Come up with a list of questions to ask at the financial statement review
3. Ask the questions at the financial statement review
4. Ask follow up questions when you do not understand the answer
5. Ask for additional information if necessary and be sure to follow up on any open issues
And One More Thing.....

You Simply Cannot Review Financial Information Wrong
Everybody Can Do This!
Helpful Hint

Know how many months remain in the fiscal year
• Becomes very important as the year progresses
• Helps determine how well operations are going for the year
• Whether any action needs to be taken
  • Take advantage of opportunities – surplus
  • Mitigate threats and weaknesses – deficit
Useful Tip

Retain your “marked up” copy of the financial statements or financial information from the financial statement reviews

• You will refer back to these financial statements and information (frequently)
• Having your notes handy will help you remember the information that was provided during the financial review
Follow the Cash – Where Did It Go

• Cash ➔ Investments, gain/loss on return, interest

• Cash ➔ Receivables, dues revenue

• Cash ➔ Accounts payable, expenses
Cash/Investments/Gain or Loss/Interest

If cash increases you might expect to see:

• A decrease in investments on the balance sheet because of a sale of investments
• A gain on investments on the income statement
• An increase in interest income on the income statement
Cash/Investments/Gain or Loss/Interest (cont.)

If cash decreases you might expect to see:

• An increase in investments on the balance sheet because of a purchase of investments

Watch out!

• Loss on sale of investments
• Decreased interest income compared to prior year
Cash/Receivables/Dues Revenue

If cash increases you might expect to see:

• A decrease in receivables on the balance sheet due to collecting outstanding dues from members

• An increase in dues revenue on the income statement
If cash decreases you might expect to see:

• An increase in receivables on the balance sheet due to outstanding dues from members not being collected

• A decrease in dues revenue when compared to prior year on the income statement
Cash/Accounts Payable/Expenses

If cash increases you might expect to see:

• An increase in accounts payable on the balance sheet because invoices have not been paid yet

• A decrease in expenses on income statement
  • No unexpected expenses as in prior year
  • Decision to cut costs
Cash/Accounts Payable/Expenses (cont.)

If cash decreases you might expect to see:

• An decrease in accounts payable on the balance sheet because invoices paid

• An increase in expenses on income statement
  • Unexpected expenses such as a costly repair
  • Expenses not controlled
Net Assets

• Net Assets are the sum total of what the association is worth

• Net Assets are **NOT** the amount available to spend on unbudgeted items
Net Assets

• Change in Net Assets is also known as the Net Income or Deficit of the association (3)

• Notice how the Net Assets at End of Year for the association shown on the Statement of Activities agrees with the Total Net Assets on the Statement of Financial Position (G)

• Therefore, Net Assets are the cumulative Net Income (or Loss) of the association from the association’s inception to year-to-date!
For Consideration

What is the significance of positive or negative Net Assets on the Statement of Financial Position?
For Consideration

• Given the financial information that is currently provided to you, is it adequate in order to determine the fiscal health of your association?

• What other information would be beneficial in order to be a fiscally informed board member?
Budgets

• Is the association budgeting for a surplus or a deficit?

• Beware the hidden contingency!

• Line Item Expense/Dues Revenue = How Much of Each Dollar Spent on that Expense
“Take-Aways”

• It is each board member’s responsibility to understand the TOTAL financial picture of the association

• It is acceptable to ask for additional information in order to completely understand the financial picture of the association
One Final Point.....

Always remember **YOU** have a responsibility to ensure that the association is financially healthy
Questions? Ideas?
Contact Information

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Session Outcomes

The content from this session can be used in the following ways in your current position/role:

- To guide and assist in reading financial statements, audit reports, and budgets
- To help spot financial red flags and know the questions to ask to follow up
- To encourage you to tell others at your association to start reading financial statements, audit reports, and budgets
Evaluation

• Please complete the evaluation for this breakout session by using the NEA Summit Mobile App!

• Please visit the Leadership Development Resources website at www.nea.org/leadershipdevelopment