



## How to make sense of the Financial Statement ('The Accounts')

### *A guide from our head of finance on what the accounts mean and in words that a non-accountant can understand (hopefully..)*



Hi, first let me introduce myself, my name is Mark Barnish and I am the head of finance for Saint John of God Hospitaller Services, which from now on I will refer to as the 'charity'.

It is part of my job to help the board of trustees to put together the annual accounts and the trustees' report.

They need to do this each year so they don't break the strict rules that charities have to follow. The main rules are that big charities, like ours, have to make their accounts available to the general public, especially those who give the charity money, so that they can get to see what we have spent the money they have given to us, on. These accounts have to be in a special format and they have to have been checked by someone outside and independent of the charity.

Before I start to try and explain the accounts I will tell you a little bit about myself. I am 57 years old and have been working with the charity since 2 April 2009. Before that I worked for two different big firms of accountants, firstly one called KPMG and then I left to join one called Baker Tilly. I was what is known as a partner in those firms. While I was there I spent most of my time checking whether lots of different companies were preparing their accounts properly and accurately. This is known as auditing and all large companies and large charities have to get their accounts checked out by an auditor.

I also dealt with many charities and, as well as my main accounting qualifications, I was awarded the Diploma in Charity Accounting in 2008. I am very proud of this qualification. In my spare time I also became a trustee of some of the local charities in my home city of Stoke-on-Trent so I have gained a lot of experience about charities and how their accounts should be prepared.

### **The problem**

Charities can be very complicated and, because they have been granted lots of special privileges, the Government has to be very careful that the public, who give their money to charities, are protected and can see where their money has been spent.

So, over the years lots of rules have been made and laws passed to try and make sure the public is protected. Some of these rules are quite complicated and this means that preparing a set of accounts can also be complicated as the accounts need to be able to show that the rules are being followed.



Because they are so complicated though, quite often those who are not accountants find them very difficult to follow. Even accountants who do not deal with charities very often can find them difficult to follow. This piece is written to try and help those of you who are not accountants understand what the accounts are saying generally (in other words what the main parts are and how to understand why they are there and why they are in the particular format they appear). Then, to also help you understand what the numbers in our charity's accounts for the year to March 2011 mean and how they relate to the comments made on pages 25 and 26 of the Trustees Report.

## What are the main parts to a set of accounts?

All charities prepare accounts for what is known as an accounting period. This is usually for a year. Charities choose and then fix when this year runs to. Many charities choose the year to run from 1 April until 31 March and our charity is one of those.

For a large charity, like ours, the accounts usually contain at least four parts:

- Trustees' Report
- Auditor's Report
- 'Primary' Statements ( these are the three main sets of numbers)
- Notes to the Accounts

This guidance note deals mainly with the third bullet point, but I have summarised below the main contents of each of the above.

**1. Trustees' Report:** This is mainly a written report setting out why the charity exists, how it is set up and managed, what it is trying to achieve, what it has done in the year to help the people it is set up to benefit and what it plans to do in the future. The trustees also have to report on certain other things if the charity is also a registered company. It is there to make sure the trustees tell everyone what they and the charity have been up to in the year and plan to do in the years ahead and what impact this has had or will have.

**2. Auditor's Report:** This report is a summary of the work that the charity's auditors have done to satisfy themselves that the accounts properly summarise what has happened to the charity's finances in the year. The auditors are those I mentioned earlier who are from outside the charity and who check the charity has been recording its financial affairs properly. Their report also tell us whether the information in the accounts has been put together in accordance with normal accounting rules and the accounts cover all the things that are supposed to be covered.

If the auditors are satisfied this is known as a 'clean' audit report. If not they give something known as a 'qualified' audit report which can tell the reader that something or things may not be all right. It is always important to read this report carefully to ensure it is a clean report.

For our charity the report is a clean report.



**3. Primary Statements:** These are three separate pages which show the overall financial position of a charity mainly in numbers format. The pages are:

- The Statement of Financial activities
- The Balance Sheet
- The Cash Flow Statement

These are covered in detail in the next section.

**4. Notes to the Accounts:** These pages contain back up details and more information about the numbers in the primary statements. So, if there are numbers in the three primary statements that you need more detail about, in order to understand them, then the notes try to give the answer by showing more detail.

The accounting rules about which numbers a charity must show in its accounts often give a choice of either showing the number or information in the primary statements, or showing them as a separate note to the accounts. In most cases the primary statements will give a cross reference where a note to the accounts gives the reader further information.

## The Primary Statements

These are the three main pages which give a summary of (i) a charity's financial performance over the accounting year for which they are prepared (namely the Statement of Financial Activities and the Cash Flow Statement) and (ii) its overall position at the end of that year (namely the Balance Sheet).

- The first of these pages, which is where we have put the link to this page in our accounts for this year, is the **Statement of Financial Activities**, often called the **SOFA**.

Other ways of describing this are the *income and expenditure account* or, in the world of profit making companies, *the profit and loss account*. For charities though, who are not there to make profits, this last description would be misleading. Originally charities used to refer to this statement as their *Income and Expenditure Account*, as this is what is summarised here. That is very simple though and the name Statement of Financial Activities is because it is recognised that charities have more than one source of income and the expenditure which often covers many different types of activities.



## Our charity's SOFA is set out below:

(Please note this is an **extract** from our audited accounts and should be viewed in this context.)

	Notes	Restricted Funds £'000	Unrestricted Funds £'000	Total 2011 £'000	Total 2010 £'000
<b>Incoming Resources</b>					
<b>Incoming resources from generated funds</b>					
Voluntary Income (donations, grants and legacies)	1b	141	282	423	983
Activities for Generating Funds		-	246	246	240
Investment Income		-	18	18	29
<b>Incoming resources from Charitable Activities</b>	1a.1	6,316	16,168	22,484	19,421
<b>Total Incoming Resources</b>		<b>6,457</b>	<b>16,714</b>	<b>23,171</b>	<b>20,673</b>
<b>Resources Expended</b>					
<b>Cost of Generating Funds</b>					
Cost of Generating Voluntary Income		-	109	109	114
Fundraising Trading - cost of goods sold and other costs		-	154	154	104
Investment Management Costs		-	14	14	11
<b>Charitable Activities</b>	1a.3	6,564	16,825	23,389	20,783
<b>Governance Costs</b>		-	30	30	29
<b>Total resources expended</b>	1a.2	<b>6,564</b>	<b>17,132</b>	<b>23,696</b>	<b>21,041</b>
<b>Net Outgoing Resources before Investment Gains/(Losses)</b>		<b>(107)</b>	<b>(418)</b>	<b>(525)</b>	<b>(368)</b>
Unrealised Gains on Investments		-	124	124	561
Realised Losses on Investments		-	-	-	(1)
<b>Net Outgoing Resources</b>	2	<b>(107)</b>	<b>(294)</b>	<b>(401)</b>	<b>192</b>
Total funds brought forward		259	2,021	2,280	2,088
<b>Total Funds as at 31 March 2011</b>		<b>152</b>	<b>1,727</b>	<b>1,879</b>	<b>2,280</b>

This statement looks very complicated so I will try and take you through it step by step. Firstly you will notice lots of different columns. The easiest of these to understand are the two on the right hand side of the page. One sets out the total figure for each type of income or expenditure that appeared in last year's accounts while the next column shows the total for this year for each type. This means you can compare the figure from last year with the figure for this year to help see what has changed from one year to the next.



There are then two other columns to the left though. The first is called '**Restricted Funds**' and the second is called '**Unrestricted Funds**'. The reason many charities have these two columns is because charity law is very strict about what you can do with each of these two different types of income and expenditure. So, where both types of income and expenditure exist, charities have to show them separately on their SOFAs.

### ***What is the difference?***

Well some people or organisations who give money to a charity may want that money which they have given to be spent on one particular thing which the charity does, or on one particular piece of work or project or service. Also they want all of the money to be spent and if any is left over will want it back. These are known as **restricted funds** and to ensure they are kept separate they are split out when the numbers are reported in the accounts.

Everything else that the charity receives or spends, which doesn't have these set rules put on it then the giver, is put into the **unrestricted funds** column.

For our charity the main income and expenditure that is restricted and appears in that column, is in where we manage the care homes which belong to other religious orders. Here, they give us a sum of money to pay for all the costs of running the homes and, if we manage not to spend all of that budget, we have to give the amount left, back to them, at a later date.

The very last number at the bottom of that column, which totals £152,000 (described as 'Total Funds'), is a summary of the amounts that either will be paid back or spent on those services or projects in future years. A list of all the different services that make up this number is also shown in note 14 to the accounts on page 40.

There is then one final column which allows the cross references to where there is more detail set out in the notes to the accounts. The reference is to the note number not the page number where it appears.

Going down the statement, the top block deals with the income of the charity and breaks the income down into pre-set headings which the charity commission has suggested are the most important types. By having set headings each charity can be compared on a like-for-like basis. These are:

**Voluntary income** - for our charity this is made up of donations and the main donors are described in note 1b in the notes to the accounts on page 35.

**Activities for Generating funds** - are things a charity does purely to raise money to support the works of the charity. These are not necessarily charitable. For our charity the income relates to the selling of plants at our garden centre and hiring out rooms at our community centre.



**Incoming Resources from Charitable Activities** - relates to where a charity is paid to carry out the charitable work it does. In our case this is where most of our income comes from, either through work we do for local councils or for other religious orders.

The next block down deals with how the money gets spent and is headed up **Resources Expended**. The first category is **Cost of Generating funds** - this allows the reader to see what it has cost in order to raise the amount of Voluntary Income and Activities for Generating funds, set out in the income analysis in the top block.

**Cost of Generating Voluntary Income** comes first - the type of cost incurred by our charity in this category is mainly to do with all the publications and newsletters we provide and our annual review publication which we send to our supporters and friends and families of people who use our services, you will see it is a very small proportion of our total income.

**Fundraising Trading – cost of goods sold and other costs** for our charity are the costs we have to pay in order to make the income described earlier as, 'Activities for Generating Funds'. So for us this is the cost of running our garden centre shop and the cost of producing the plants we sell and the cost of administering the community centre.

The next major heading under Resources Expended is **Charitable Activities**. This is the easiest to understand as it is a summary of the costs of delivering the charitable things we do including the internal support costs for them. These support costs are separated out in detailed notes to the accounts set out on page 35 notes 1a.3 and 1a.4.

Charities are also asked that where they carry out different types of activities to break these down in to the main ones. Some charities do this in their statement, others do it in their notes to the accounts. We have done it in our notes to the accounts to make the statement easier to read. We have also split our income over the same headings in note 1a.1 on page 34, so that you can see how much we have spent compared to how much we have received for each activity.

The Charity Commission also asks for one section of support costs to be shown separately under the heading of **Governance Costs**. These are the specific costs that the trustees need to spend money on in order to meet the rules on regulation which apply to charities.

All these costs are then totalled against the heading **Total Resources Expended**.

Immediately after the heading Total Resources Expended there is a heading which shows the overall gain or loss for each type of funds and the total for the year. In other words all the income less all the costs. For our charity this shows we had an overall deficit or loss for the year ended 31 March 2011 of £525,000.

The final block on our SOFA deals with the movements on our investments. Where investments are sold in a particular year there will be gain or loss based on the amount received compared to what they have previously been included in the accounts at. This amount in total is shown as **Realised Gains or Losses**. Because investments are included at their latest value in the accounts at a year end



there may be theoretical gains or losses which have to be shown. These are known as **Unrealised Gains or losses** and also dealt with in this block.

Finally here we show what the total cumulative balances on the restricted and unrestricted funds were at the beginning of the year, add in the total surplus or deficit for the year and show the revised amount to be carried forward into next year.

I have not given any more detail here on what the overall picture has been for our charity and why the deficit referred to above occurred, because there is quite a long explanation of the overall results on pages 25 and 26 within the trustees' report.

Hopefully the words in that section will now be easier to understand when you are looking through the statement of financial activities.



- The second of the Statements is called the Balance Sheet

**The Balance Sheet for our charity as at 31 March 2011 is set out below:**

	Notes	2011		2010	
		£'000	£'000	£'000	£'000
<b>Fixed Assets</b>					
Tangible Assets	5		1,027		1,410
Investments	6		1,499		1,681
			<b>2,526</b>		<b>3,091</b>
<b>Current Assets</b>					
Stock	7	25		25	
Debtors	8	2,602		2,213	
Cash at Bank and in Hand		148		126	
<b>Total Current Assets</b>		<b>2,775</b>		<b>2,364</b>	
Creditors: Amounts falling due within one year	9	(3,208)		(2,817)	
<b>Net Current Liabilities</b>			<b>(433)</b>		<b>(453)</b>
<b>Total Assets less Current Liabilities</b>					
			<b>2,093</b>		<b>2,638</b>
Creditors: Amounts falling due after more than one year	11		(214)		(341)
Provisions for liabilities and charges	12		-		(17)
<b>Net Assets</b>			<b>1,879</b>		<b>2,280</b>
<b>Funds</b>					
Unrestricted Funds	13	1,727		2,021	
			<b>1,727</b>		<b>2,021</b>
Restricted Funds	14		152		259
<b>Total funds</b>			<b>1,879</b>		<b>2,280</b>

It is called the 'Balance Sheet' because all the surpluses a charity has made over its life (known as its reserves) should be represented at any point in time (in this case the last day of the financial year) by its assets and liabilities and the sum of those two different aspects of the charity should equal each other and be in balance.

Once that concept of balance is understood it is quite easy to understand the second primary statement, ie the Balance Sheet which is set out above.



The top part of the statement, down to the heading 'Net Assets' is a summary of the different assets and creditors the charity has. Net means the overall position when you add up all the values of the assets and subtract all the value of the liabilities (amounts the charity owes) at the year end. Again the same information from the previous year end is shown in the right hand column to enable you to see how the different assets and liabilities have moved and what the overall 'net' position is.

The main thing this shows for our charity is that the building held and used as offices for our Northern Region at the beginning of the year was sold during the year (this can be seen more clearly by looking at one of the notes to the accounts, on page 37 note 5 'disposals') and it explains why the total for fixed assets had reduced by so much by 2011. As we will see later when we look at the Cash Flow Statement, the cash that arose from the sale helped provide cash to offset the cash going out as a result of the losses shown on the Statement of Financial Activities.

Again there are more detailed comments in the Trustees' Report on page 25 which explain other movements.

- The final Primary statement in the accounts is the one entitled "***The Cash Flow Statement***". This is possibly the most complicated of the three primary statements.

The main purpose of this statement is to show how a charity's cash position has changed in the year. The reason that it is complicated is that the Statement of Financial Activities, which records the overall increase or reduction in a charity's funds during a financial year (and therefore net assets), contains many items that don't necessarily effect cash straight away or indeed ever directly result in a cash movement.

So for example when a charity buys a capital item, let's say some expensive equipment, this is not shown immediately in the Statement of Financial Activities. Because we are buying an asset that will last for many years we pay out the cash and reduce the cash in our balance sheet, but then increase our Fixed Assets also in our Balance Sheet. So the cash impact of this has no connection with the gains or losses shown in the SOFA. But, as the asset wears out we do put a cost into the SOFA each year to record the wearing out of the asset over its life. That cost again is not a cash transaction. This is one of several examples of a timing difference between when we spend money or collect money compared to and when it is registered into the SOFA as a cost or income item.

Because of the differences in timing you need to build a bridge between how the balance sheet moves and how the SOFA moves in order to understand how this affects cash and long term debt. It is the cash flow statement which builds this bridge.

This statement helps us understand how much of the movement in the SOFA and the movement in the balance sheet from the previous year to this effects cash. It also shows where any new cash has come from. It helps readers to judge whether there is a problem for the charity, if it is losing its cash too quickly.



**Our cash flow statement is reproduced below:**

	Notes	2011	2010
		£'000	£'000
<b>Reconciliation of Net Outgoing Resources to Net Cash (Outflow)/Inflow from Operating Activities:</b>			
Net Outgoing Resources from Operations		(525)	(368)
Depreciation		260	261
Profit on Disposal of Fixed Assets		(38)	-
Increase in Stocks		-	(25)
Increase in Debtors		(389)	(565)
Increase in Creditors and Provisions		188	971
Return on Investments		(7)	-
<b>Net Cash (Outflow)/Inflow from Operating Activities</b>		<b>(511)</b>	<b>274</b>
<b>Cash Flow Statement:</b>			
Net (Outflow)/Inflow Cash from Operating Activities		(511)	274
Return on Investments and Servicing of Finance	16	8	-
Capital Expenditure and Financial Investment	16	467	249
<b>Cash (Outflow)/Inflow before use of Liquid Resources and Financing</b>		<b>(36)</b>	<b>523</b>
Financing	16	(132)	456
<b>(Decrease)/Increase in Cash in the Year</b>		<b>(168)</b>	<b>979</b>
<b>Reconciliation of Net Cash Flow to Movement in Net Funds:</b>			
(Decrease)/Increase in Cash in the Year		(168)	979
Cash Outflow/(Inflow) from Changes in Net Debt and Lease Financing		132	(456)
(Increase)/Decrease in Net Debt Resulting from Cash flows	17	(36)	523
<b>Change in Net Debt</b>	<b>17</b>	<b>(36)</b>	<b>523</b>
<b>Net Debt at 1 April 2010</b>	17	(504)	(1,027)
<b>Net Debt at 31 March 2011</b>	<b>17</b>	<b>(540)</b>	<b>(504)</b>

The first block shows how our day to day operations compare between the SOFA and actual cash movements. The total SOFA movement for operations over the year is shown as – **‘Net outgoing resources from operations’**. This part of the statement then shows those items in the SOFA which are not cash movements and those balance sheet items which have moved due to our activities and have had a knock on impact on cash. So, for example if we have more money tied up in debtors then this means more of our income has not been turned into cash. This is then totalled to show the overall impact of our operations in cash terms **‘Net cash (outflow)/ Inflow from operating activities’**. As with all these statements the previous year’s figures are shown on the right hand side.

The next block deals with items which are of a ‘financing nature’ such as purchasing and selling fixed assets and interest on cash type investments. It goes on to show financing type items such as repaying long term bank loans etc. This then gives an overall picture of how much cash has



decreased or increased in the charity, and is totalled to show the actual **(Decrease)/Increase in Cash in the year.**

The final block details how much 'other borrowings' have increased or decreased by. This then gives the overall position for cash and other financing (e.g. bank loans, mortgages etc.). The details behind each of the above are then shown in back up notes to the accounts set out on page 42.

The cash flow picture for our charity is summarised on page 25 of the trustees' report. What the statement shows in order of the blocks described above is that for our activities the overall deficit of £525,000 seen in the SOFA was similar to the cash impact of those activities which was only slightly lower with a cash outflow of £511,000. But, the sale of a property, (as mentioned earlier) together with the sale of some of our investments, offset by capital expenditure meant an inflow of funds of £475,000, which meant the 'cash resources' or Net Debt as it is also referred to only fell by £36,000.

That said the split of this between cash and bank term loan did change with cash at bank reducing by £168,000 but the term loan and lease creditors also reducing by £127,000 also. That can be seen in the note to the cash flow on page 42 (note 17).

Bank overdrafts are not classed as net debt in this for the Cash Flow Statement but part of the cash movement shown in the top block.

## Conclusion

So there it is... When I started writing this I had hoped it would be a *short* and simple guide to the accounts, but, it has turned into something a little bit lengthier than I envisaged. This I think is a factor of how complex charity accounts are and there is no really quick way to explain them which also does justice to their complexity.

Despite not meeting the target I set for length, I hope you now have a better understanding of what the accounts mean and how they link together. If you don't and feel you need more explanation, including what they say about our charity's performance and position, please e-mail me or write to me using the following contact details:

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