BETTER BOARDS
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F i n a n c i a l Reporting for NFP Directors

W o r k b o o k

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David, by profession, is an Australian Chartered Accountant. He worked in the accounting profession at Ernst & Young Australia for over 20 years. This experience consisted of 15 years auditing and nearly seven years as National Director of Education.

David is well regarded for his passionate, insightful and knowledgeable facilitation skills. He has been one of the financial modules facilitators for the Australian Institute of Company Directors for almost twenty years. David graduated from the Australian Institute of Company Directors, Company Directors Course in 2009. From 1992 to 1994 David completed a Masters of Education at New South Wales University part time.

David is author of:

- *Financial Statements Demystified* published by Allen & Unwin. The fourth edition was published in March 2006. Over 25,000 copies have been sold since March 1993.
- *Assessing Company Performance* CD ROM published by Kaplan Higher Education, third edition, January 2008 is a companion to his book and the Kaplan subject that he has authored for 25 years. People can practice and enhance their understanding of financial statements, accounting concepts and ratio analysis through the CD ROM.

David is also the main author of the two financial modules in the Australian Institute of Company Directors (AICD) *Company Directors* and *International Company Directors* courses and has contributed to writing parts of other courses.

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FINANCIAL REPORTING TO NFP BOARDS

Two Key Principles

Less is more

Top down

It is likely you are receiving too much information at board meetings for you to reasonably digest. For instance, financial reporting directly generated by the accounting system can be voluminous, detailed and poorly laid out. *Less is more* when financial reporting is determined based on presenting clear, concise and relevant information. This will usually be a mixture of numbers, text and graphical representation. This usually includes transferring information from the accounting system to spreadsheets. Directors need to obtain comfort that the information is reliable.

Top down facilitates clarity by providing the over all picture. The more that detail can be provided by exception, the less information needs to be provided – two examples:

- The current ratio – your organisation has a standard of 1.2 or higher. Only if the ratio falls below that level is it reported.
- Reporting actual to budget – written explanations of variances to budget are required only when the variance is the greater of $10,000 or 10%, whichever is the higher amount.

Reporting by exception is a great way of reducing detail, but directors need to be satisfied that such exceptions will be reported.

Top down can start with an overview of key elements page followed by pages that logically support the overview page and cascade down to the extent necessary. The overview page is likely to include information from the three financial statements (income statement, cash flows statement, balance sheet), ratios and key performance indicators (KPIs).

An automated version of top down is the *performance dashboard*. Wikipedia has information at:

< http://en.wikipedia.org/wiki/Dashboard_(management_information_systems)>

This can be a very powerful way to keep abreast of key matters. To be effective the dashboard must limit information to key performance elements that are regularly (daily?) updated. To achieve this, the dashboard is automated and links to automated, robust, reliable and integrated information systems.

Future and Past

Financial reporting needs to be forward and backward looking. Reporting to the board is enhanced when:

- reporting is in context of strategy
- corporate plan of at least three to five years built in context of strategy and containing some budgeted financial figures
- annual financial budget – income statement, at minimum; likely cash flow forecast and perhaps balance sheet, ratios and KPIs
- reporting during the financial year being year to date (with latest month) – income statement and balance sheet at minimum; useful if also cash flows statement, ratios and KPIs
- five year view of previous financial years – income statement, cash flows statement, balance sheet and ratios
- same format for budgets and historic reporting

The following provides information and suggestions for achieving enhanced reporting following the *less is more* and *top down* principles.

Why five years?

Five years is recommended as minimum for accumulating past information. Analysts recommend five, minimum three, years in order to provide context and display trends. Research shows that we think better when we have context – time provides context.

The accounting system usually does not maintain data to generate five year reports. Typically, you will need to enter data into an Excel spreadsheet. See The Smith Family example to demonstrate this under *An NFP Historic Reporting Example* in the following section. If there has been significant change, the five year comparison may not be as useful. If it is a new organisation, historic information will not be available.

Review budgets in context

Reviewing budgets typically includes comparing with previous actual. Consider requiring at least three years of actual figures to give a better context.

Obtaining more comprehensive reporting

Accounting systems automatically generate income statements and balance sheets. While accounting systems might enable cash flow forecasting, they usually do not generate historic cash flows statements. Accounting systems might have report generation capability but it is often cumbersome. Hence, accountants often transfer data to spreadsheets to generate reports, including those presented to the board.

This means that if you want comprehensive reporting (three financial statements, ratios and KPIs) your organisation will have to do this using spreadsheets. If you are a small organisation, other than accumulating historic annual financial data, it might not be worth the effort. If you are larger, it will be worth the effort.

Generating YTD cash flows statements

Organisations producing annual reports that include a cash flows statement usually generate the statement through a spreadsheet. If your organisation's annual financial statements include a cash flows statement, it should be possible to have a year to date cash flows statement included in the financial reporting during the year. This is done by adapting the spreadsheet that generates the annual cash flows statement to generate a year to date one.

Obtaining assurance

The accounting system has inherent reliability due to double entry processing. However, this does not guarantee the information is correct. There are two risks inherent in the accounting system being: incorrect account coding and missing entries.

More comprehensive reporting means information is transferred to spreadsheets. There is significant risk that the spreadsheets are deficient in control checks to ensure all the information is transferred and integrity is maintained.

How do directors obtain assurance? If you are large enough, internal audit can do additional work that is reported to the board or the audit and assurance committee. If smaller and there are external auditors, engage them. If small and an external accountant assists with annual reporting, then engage the accountant.

Clustering

Accounting systems and accountants default order of expenses is alphabetical. This means if you call the account for paying people 'payroll' it is under 'P'; 'salaries' it is under 'S' and 'wages' it is under 'W' – useless! Generally, it is better to have all costs associated with paying people grouped together.

The concept of cost centres groups expenses within each area of the enterprise in which they occur. In a member-based not for profit (NFP) this could be association, board, office, member services. In such classifications it is worthwhile clustering costs meaningfully, especially when there are a number of expenses for a cost centre.

A way of improving income statement expense reporting is by meaningfully clustering expenses. This applies particularly to smaller NFPs. If your expenses are listed in alphabetical order, then the following two examples of clustering are of interest.

University residential college

Expenses can be clustered under:

Building
: expenses include depreciation, maintenance, insurance, security

Staff
: expenses include salaries, holiday leave, superannuation, fringe benefits tax, staff training

Office and administration
: expenses include audit, professional services, bank fees, motor vehicles, travelling, postage, IT support

Student services
: expenses include catering, cleaning, utilities (electricity, gas and water)

Student education and support
: useful when services are provided in addition to board and lodgings: expenses include bursaries, tutorial support, library, internet research resources access

Member association

Expenses can be clustered under:

Association
expenses include audit, constitutional and legal

Board/council
expenses include meeting costs such as venue, catering, accommodation and travel – where an executive committee exists, it can be separately monitored as *executive committee*; where the chair/president or other officials are provided with honorariums and other support, this could be separately monitored as *officers*.

Office
expenses include staff costs, property costs (eg rental, depreciation if own building, maintenance), equipment costs (eg leasing, depreciation, maintenance), information technology costs

Member services
expenses include conference, seminar and events costs, member magazine costs (print and web based), member surveys and research

Member benefits
expenses include scholarships, grants to local member groups

NFP Example

The following is an example of a large professional member based association where the chief financial officer (CFO) has provided excellent reporting and recommended financial goals and reporting to the board. The annual budget consists of 14 pages while the regular reporting is 8 pages as described below.

Annual budget

The 14 page annual budget consists of:

- two pages of overall explanation and recommendations
- one page income statement budget
- eleven pages of explanation of each revenue and expense line in the budget

The budget is prepared several months before the end of the current financial year. The income statement shows the budget with the three right hand columns being the current and prior two years. This gives excellent context. The current financial year 'actual' figures are an estimate being the year to date actual plus estimates for the remaining months. These estimates are based on the original budget and adjusted for trends and matters now expected by the end of the year. Estimation of the 'actual' is typical and needs to be done well.

The format of the income statement is exactly the same as the regular reporting. The format is revenue line items less expense line items (less than 10 of each) to give operating surplus followed by investment income. The financial goals are based on targets for operating surplus and investments earnings. This format enables these targets to be monitored. There is a history of budget reliability and the organisation is cash and investment rich. In this situation a cash flow forecast is unnecessary. As long as the operating budget is achieved, the cash will flow sufficiently. Even if there is a problem in any one year, sufficient cash is held to deal with it. This demonstrates that less is more. Why have forecast statements that are not needed? However, many NFP organisations are not in such a situation. A cash flow forecast is usually sensible.

The two page general explanation provides explanation in terms of the overall corporate plan and goals and issues for the coming financial year.

The 11 pages of explanation are well prepared. The derivation of each revenue and expense line is well explained. The approach varies to address the item. For instance, membership fees is explained based on membership numbers, expected increase in members and membership rates. The increase in membership is explained based on trends from the past demonstrated by numbers of eligible members generated from institutions and proportion that become members. The employee costs are explained by looking at employee numbers (in full time equivalent terms) and wages over the last ten years. Allowance is made for reductions or increases that influence employee numbers.

The information is so well prepared that a director is unlikely to have many questions. Any questions a director might think of are likely to be answered in the explanations provided.

Regular reporting

The 8 page regular report consists of:

- three pages of financial statements – income statement, balance sheet and cash flows statement including reconciliation of the surplus (profit) to the operating cash flows
- three pages of specific commentary of actual variances to budget
- two pages of performance measurement on membership generation, surplus history and ratios displayed in graphical form

Again the quality is superb. The explanations of variances of actual to budget are concise and particular. Often explanations can be very generalised and uninformative, but not here.

While the membership and surplus history information is useful, the ratio information is not needed. As long as the organisation achieves its income statement goal at the operating surplus level and investments are performing reasonably then all the ratios will be satisfactory. Only if performance was not achieved might the ratios be helpful. In other words ratio reporting by exception could be useful. This means the regularly reporting could be handled in seven pages!

As in the budget, directors are unlikely to have many questions because pertinent questions are addressed in the commentary.

The reporting is generated through spreadsheets. No information is generated directly from the accounting system. Therefore, in this situation, the board should consider obtaining independent vetting of spreadsheet quality and the information provided.

AN NFP HISTORIC REPORTING EXAMPLE

The Smith Family is used as the example in reporting historic financial performance over time and is in the five pages following this explanation of the spreadsheet. The Smith Family is used as it is a well known charity. It provides an example of the usefulness of seeing information over time. It has been compiled from using publicly available information in the audited financial statements. No contact was made with the organisation. No commentary is provided in these materials on the financial performance.

Figures were entered from the audited financial statements available on The Smith Family website into an Excel spreadsheet that David Hey-Cunningham & Associates Pty Limited has developed for NFP organisations. Earlier versions of this spreadsheet have been used for several in-house seminars and have provided valuable insight. The spreadsheet is available for purchase at $50 including GST. Email <davidheyc@bigpond.com> if you would like more information or would like to purchase.

The following is a brief description of the logic of the spreadsheet, which is designed to accumulate the annual figures over time. Thus, it is updated after the final financial figures have been determined, approved by the board (or equivalent) and audited (if this applies).

There is always a risk that information entered in a spreadsheet will compromise one of the major strengths of double entry bookkeeping – *all items balance*. While the spreadsheet computes all sub totals and totals, it requires three totals to be entered, one from each of the financial statements:

- net surplus being the final profit/(loss) or surplus/(deficit) for the year after income tax shown on the income statement;
- cash at the end of the financial year as shown on the statement of cash flows; and
- total equity as shown on the balance sheet (also called statement of financial position).

The spreadsheet shows 'true' for each of these totals when that calculated by the spreadsheet agrees with the totals entered. A difference will show when the amounts do not agree. Differences will show and are expected until you have entered all the amounts. Once you have done this for a year, check that 'true' is showing. If there is a difference, check you have entered the correct total from the financial statements, then check the entry of each line item. If there is still a difference, check the addition of the financial statement itself. There might be an error in its preparation.

The balance sheet performs another self-check being checking that the net assets (total assets less total liabilities) computed by the spreadsheet equals the total equity computed by the spreadsheet. It shows 'true' when they agree and shows the difference when they do not agree. If there is a difference here, this needs to be investigated similarly for the other differences.

Income Statement

The income statement is presented in dollars (1 page) and percentages (1 page). Information is entered in the income statement in dollars. The income statement in percentages expresses the dollar information as a percentage of total revenue. This provides a comparative view over time by showing each line as a relative percentage of total revenue. (In commercial enterprises examination of the profit and loss items is usually as a percentage of sales as this is generally the major revenue item. However, NFP organisations often have three or four significant revenue sources. Thus, examining as a percentage of total revenue is more useful.)

General entry instructions:

- names of revenue, expenses and unusual items are entered in the first column under each of those headings; amounts are then entered against the relevant line item names
- investment items are entered in totals against the appropriate lines of investment revenue, expenses and revaluation
- interest expense and income tax expense are entered against the line items as already named in the spreadsheet

The income statement looks at surplus before each of investments, interest expense, unusual items and tax (which is typically nil). You can choose the extent you want to look at these levels of surplus. If investments and interest expense are relatively small amounts, then you can choose to include them within revenue and expenses as appropriate. In The Smith Family example:

- interest earned has been included within revenue as the investments are mainly cash holdings and not that significant in revenue terms
- interest expense is small and declining due to repayment of small levels of borrowings over the five years; hence, interest expense is included within expenses
- two items have been segregated as unusual due to their size being discontinuing operations and large surplus on disposal of assets

The separation of revenue and expenses that are unusual compared with normal operations means the surplus excluding them is calculated. This is your choice as you enter the information and amounts. In summary, this format enables you to view surplus at different levels:

- The surplus before investments shows the surplus independent of investment revenue, expenses and revaluation. Where investments are significant, segregating them provides a view of the 'operating surplus'. For instance, your organisation might target a level of operating surplus independent of investments. This format enables you to see the result.
- The surplus before interest expense (EBIT – earnings before interest and tax) provides a view of surplus before borrowing costs. This can be very useful when borrowings are significant (remembering that borrowings often do not exist for many NFPs).

- The surplus before unusual items aims to show the situation from normal operations before unusual items being items that are unusual due to their nature (type) or large size. These items are usually expenses but can be revenue as one is in The Smith Family example.
- The surplus before tax is last as most NFP entities are income tax exempt.

Cash Flows Statement

Enter this information if this statement is provided in your annual financial statements. Otherwise do not enter any information.

The statement of cash flows accounting standard is the best accounting standard. It provides a summary of all deposits and withdrawals through the bank accounts over the year summarised, cleverly, under operating, investing and financing. This format is recommended for internal cash flow information, including cash flow forecasts. Operating cash flow is very helpful in considering whether or not an entity is solvent.

The names of the items are set in this statement. Your statement will generally use the same or similar names. Sometimes you might find you need to combine some of your items under one line on this statement. The names shown here are the typical ones that are likely to exist in a NFP organisation. Additionally, in the first year of entering the data, enter the cash at the beginning of the financial period. This is automatically done for following years.

When interpreting the cash flows statement the key is the flow of the cash in each financial year. This contrasts with the income statement where the key is the 'bottom line', being the surplus or deficit in each financial year.

For an ongoing NFP, cash is expected to flow from operating activities. If borrowings are used, then this is usually a source of cash occasionally and then, generally, principal is expected to be repaid from operating cash flows. If investments exist, then they might be used to repay principal.

Many NFP organisations generate surpluses over time. This means they generate operating cash flows. This generation can be strong enough to enable the organisation to invest in cash and other kinds of investments. Payments for investments will be shown under investing activities.

All organisations need adequate infrastructure in order to operate effectively and efficiently. To the extent the infrastructure is rented the payments are part of operating cash flows under payments to suppliers and employees. To the extent the assets are owned, the payments for property, plant and equipment are included under investing activities.

Proceeds from sale of property, plant and equipment are received from time to time and are usually much less than what was originally paid. An exception, is usually proceeds from sale of property (land and buildings).

Payments for property, plant and equipment is the common item under investing activities, thus investing activities is expected to be negative as cash is used in acquiring these assets.

In typical years, it is desirable for a NFP to self-generate, meaning that net cash flows from operating cash flows should be greater than the payments for property, plant and equipment included within investing activities. The spreadsheet computes the self-generation at the end of the cash flows statement.

However, when extensive acquisition of property, plant and equipment (usually being a property) occurs, self-generation is unlikely. Consider, in this circumstance, how the acquisition is funded: extent from the year's operating cash flows, from cash holdings at the beginning of the year, from proceeds from disposal of investments and from borrowings.

Balance Sheet

The names of the items are set in this statement. Your statement will generally use the same or similar names. The names shown here are the typical ones that are likely to exist in a NFP organisation. Under each of current and non-current assets and liabilities, the final line item is 'other' in which you enter all amounts for items that are not one of the items separately shown.

Under liabilities it is important to enter unearned income items on that line under either current (usually) or non-current, whichever apply. These items are often included within payables. The payables note will list them. Unearned income are items such as grants received in advance and fees for services received but yet to delivered. An example is an association that collects memberships fees and seminar fees before the financial year end but the membership straddles or begins on the financial year end and the seminar is scheduled in the new financial year.

Under equity two lines are allowed being for retained surpluses (profits or earnings, as named) and reserves. There is no line item for contributions such as share capital as members do not contribute such to a NFP organisation.

Ratios

Ratios are calculated under five headings: liquidity, efficiency, financing, profitability and size. Relevance varies greatly between NFP organisations. Efficiency can be important when assets are significant. Financing is important when borrowings are used to a significant degree. Surplus ratios can be of interest when relatively large surpluses are generated, eg when the NFP is based on a business model. The size ratios show the percentage change in total revenue and assets year to year.

The Smith Family
Income Statement

	2008	2009	2010	2011	2012
	$	$	$	$	$
Revenue					
Sale of commercial good	31,723	29,269	14,733	15,162	16,453
Government grants	8,506	9,442	12,499	16,525	17,434
Commercial and personal fund raising	37,786	36,307	36,582	42,775	43,958
VIEW Clubs	5,753	5,475	5,480	5,313	5,078
Interest earned	1,218	530	404	680	684
Other income	58	334	497		
Surplus on disposal of assets	667	2			
Rental income, dividends & other programs				1,246	756
Realised gains/(losses) on share investments				(143)	(155)
Other revenue					
Total revenue	85,711	81,359	70,195	81,558	84,208
Expenses (enter as negative figures)					
Community programs	(36,751)	(38,411)	(40,532)	(51,384)	(53,770)
Commercial	(29,751)	(28,175)	(12,527)	(13,013)	(16,405)
Fundraising	(7,750)	(6,722)	(8,008)	(8,640)	(10,178)
Positioning and profiling	(3,324)	(3,339)	(2,087)	(2,157)	(2,625)
VIEW Clubs	(5,391)	(5,148)	(4,833)	(4,753)	(4,235)
Shared services	(1,789)	(2,064)	(1,448)	(1,757)	(1,836)
Interest expense	(240)	(237)	(206)	(125)	(30)
Unrealised foreign currency (gain)/loss		(10)			
Other expenses					
Total expenses	(84,996)	(84,106)	(69,641)	(81,829)	(89,079)
Surplus before investments	715	(2,747)	554	(271)	(4,871)
Investments					
Revenue					
Expenses					
Revaluation					
Total investments	0	0	0	0	0
Surplus before interest expense	715	(2,747)	554	(271)	(4,871)
Interest expense					
Surplus before unusual items	715	(2,747)	554	(271)	(4,871)
Unusual items	0	0	2,272	(4,796)	467
Surplus before tax	715	(2,747)	2,826	(5,067)	(4,404)
Income tax expense					
Net surplus	715	(2,747)	2,826	(5,067)	(4,404)
Profit after tax' from financial statements	715	(2,747)	2,826	(5,067)	(4,404)
Agree or difference	True	True	True	True	True
Unusual items					
Surplus/(Deficit) from discontinuing operations			126	(4,796)	467
Large surplus on disposal of assets			2,146		
Total unusual items	0	0	2,272	(4,796)	467

Income Statement	2008	2009	2010	2011	2012
Expressed as % of total revenue	%	%	%	%	%
Revenue					
Sale of commercial good	37%	36%	21%	19%	20%
Government grants	10%	12%	18%	20%	21%
Commercial and personal fund raising	44%	45%	52%	52%	52%
VIEW Clubs	7%	7%	8%	7%	6%
Interest earned	1%	1%	1%	1%	1%
Other income	0%	0%	1%	0%	0%
Surplus on disposal of assets	1%	0%	0%	0%	0%
Rental income, dividends & other programs	0%	0%	0%	2%	1%
Realised gains/(losses) on share investments	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
Other revenue	0%	0%	0%	0%	0%
Total revenue	100%	100%	100%	100%	100%
Expenses					
Community programs	-43%	-47%	-58%	-63%	-64%
Commercial	-35%	-35%	-18%	-16%	-19%
Fundraising	-9%	-8%	-11%	-11%	-12%
Positioning and profiling	-4%	-4%	-3%	-3%	-3%
VIEW Clubs	-6%	-6%	-7%	-6%	-5%
Shared services	-2%	-3%	-2%	-2%	-2%
Interest expense	0%	0%	0%	0%	0%
Unrealised foreign currency (gain)/loss	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
0	0%	0%	0%	0%	0%
Other expenses	0%	0%	0%	0%	0%
Total expenses	-99%	-103%	-99%	-100%	-106%
Surplus before investments	1%	-3%	1%	0%	-6%
Investments					
Revenue	0%	0%	0%	0%	0%
Expenses	0%	0%	0%	0%	0%
Revaluation	0%	0%	0%	0%	0%
Total investments	0%	0%	0%	0%	0%
Surplus before interest expense	1%	-3%	1%	0%	-6%
Interest expense	0%	0%	0%	0%	0%
Surplus before unusual items	1%	-3%	1%	0%	-6%
Unusual items	0%	0%	3%	-6%	1%
Surplus before tax	1%	-3%	4%	-6%	-5%
Income tax expense	0%	0%	0%	0%	0%
Net surplus	1%	-3%	4%	-6%	-5%

Cash Flows Statement	2008	2009	2010	2011	2012
	$	$	$	$	$
Operating activities					
Receipts from customers	31,581	31,966	32,329	32,227	18,920
Other revenue received	53,219	52,076	59,585	64,935	73,707
Payments to suppliers and employees	(86,252)	(85,926)	(88,253)	(92,604)	(87,387)
Other operating payments					
Other investment income received	1,218	540	404	666	718
Interest received	362	529	222	586	223
Interest paid	(303)	(236)	(206)	(125)	(30)
Income tax paid					
Net cash from operating activities	(175)	(1,051)	4,081	5,685	6,151
Investing activities					
Payments for property, plant and equipment	(1,262)	(1,531)	(1,294)	(1,926)	(1,180)
Proceeds from sale of property, plant and equip	1,189	2	2,568		
Proceeds from sale of investments					1,222
(Payments) for investments	(7,200)				
Other investing receipts/(payments) net					
Net cash from investing activities	(7,273)	(1,529)	1,274	(1,926)	42
Financing activities					
Proceeds from borrowings					
Proceeds from finance leases					
Repayment of borrowings	(1,334)	(980)	(980)	(980)	(735)
Repayment of finance leases					
Net cash from financing activities	(1,334)	(980)	(980)	(980)	(735)
Net change in cash	(8,782)	(3,560)	4,375	2,779	5,458
Cash at beginning of year	21,140	12,358	8,798	13,173	15,952
Other changes in cash holdings					
Cash at end of year	12,358	8,798	13,173	15,952	21,410
Cash at end of year' from financial statements	12,358	8,798	13,173	15,952	21,410
Agree or difference	True	True	True	True	True
Self generation					
Net cash from operating activities	(175)	(1,051)	4,081	5,685	6,151
Payments for property, plant and equipment	(1,262)	(1,531)	(1,294)	(1,926)	(1,180)
positive means self-generation	(1,437)	(2,582)	2,787	3,759	4,971

Balance Sheet	2008	2009	2010	2011	2012
Assets	$	$	$	$	$
Current assets					
Cash	12,358	8,798	13,173	11,790	17,256
Receivables	6,550	4,687	5,190	3,889	1,357
Inventories	3,911	4,146	5,153	1,719	1,424
Investments		422		4,162	4,154
Other current assets				4,453	
Total current assets	22,819	18,053	23,516	26,013	24,191
Non-current assets					
Property, plant and equipment	13,838	13,592	13,665	7,798	6,360
Investments	9,345	8,483	10,221	11,262	11,652
Intangible assets	281	84	137	307	1,715
Other non-current assets					
Total non-current assets	23,464	22,159	24,023	19,367	19,727
Total assets	46,283	40,212	47,539	45,380	43,918
Liabilities					
Current liabilities					
Trade and other payables	6,614	5,990	5,174	6,008	4,620
Borrowings	980	980	980	735	
Provisions	3,524	3,346	3,641	3,960	3,377
Unearned income	1,925	1,788	7,003	7,529	15,466
Other current liabilities				1,593	
Total current liabilities	13,043	12,104	16,798	19,825	23,463
Non-current liabilities					
Borrowings	2,695	1,715	735		
Provisions	676	669	703	890	969
Unearned income					
Other non-current liabilities					
Total non-current liabilities	3,371	2,384	1,438	890	969
Total liabilities	16,414	14,488	18,236	20,715	24,432
Net assets	29,869	25,724	29,303	24,665	19,486
Equity					
Reserves	(685)	(2,083)	(1,330)	(901)	(1,676)
Retained profits	30,554	27,807	30,633	25,566	21,162
Total equity	29,869	25,724	29,303	24,665	19,486
Net assets = Net equity (agree or difference)	True	True	True	True	True
Total equity' from financial statements	29,869	25,724	29,303	24,665	19,486
Agree or difference	True	True	True	True	True

Ratios	2008	2009	2010	2011	2012
Liquidity					
Current ratio (current assets/current liabilities)	1.7	1.5	1.4	1.3	1.0
Efficiency					
Revenue to assets (total revenue/total assets)	1.9	2.0	1.5	1.8	1.9
Financing					
Interest cover	-4.0	10.6	-3.7	1.2	161.4
Debt to equity (liabilities/equity)	0.0	-0.1	0.0	0.0	-0.1
Borrowings to equity	0.0	-0.1	0.0	0.0	-0.2
Profitability					
Return on revenue (surplus bef interest/tot rev)	1.1%	-3.1%	1.1%	-0.2%	-5.7%
Return on assets (surplus before interest/assets)	2.1%	-6.2%	1.6%	-0.3%	-11.0%
Return on equity (surplus before unusls/equity)	2.4%	-10.7%	1.9%	-1.1%	-25.0%
Size					
Change in revenue (annual change/PY revenue)		-5.1%	-13.7%	16.2%	3.2%
Change in assets (annual change/PY assets)		-13.1%	18.2%	-4.5%	-3.2%

PY means prior year

OVERVIEW OF FINANCIAL STATEMENTS

Summary of the Three Financial Statements

Figure 2.4
The three financial statements

Balance sheet	***Income statement***	***Cash flow statement***
Snapshot at a point in time, the balance sheet date	History of revenue less expenses over the period between balance sheet dates	History of cash in less cash out over the period between balance sheet dates
Formula L + E = A or E = A – L where: A is assets L is liabilities E is equity	*Formula* P = R – E where: P is profit R is revenue E is expenses	*Formula* Cash: In (Out)

This PowerPoint slide from David Hey-Cunningham (2006) *Financial Statements Demystified*, 4th edn, Allen & Unwin, Sydney – page 24

Management and Published Financial Statements

Listed companies produce published financial statements under laws in countries where their shares are listed. International Financial Reporting Standards (IFRS) are being adopted by more countries, giving a common framework for preparing and presenting financial statements. Internally you use information derived primarily from the general ledger, which are typically referred to as the management accounts. A lot more detail is available, especially about the profit and loss.

What should also be available are budgets and cash flow forecasts. Budgets are projected profit and loss statements. Budgets are developed from last years actual and budgets. During the year the actual results are compared with budget and the previous year. Thus there is a cycle of budgeting - actual - budgeting.

Cash flow forecasts are estimates of cash in and out. Published cash flow statements are about cash in and out over the last year. Forecasts for the year are generally cash in and out month by month or, especially for the first three months, week by week. The treasury area of big organisations often do it day by day.

Historical cash flow statements are usually not provided in management accounts for executive and board. This is a problem. We check reasonableness of budgets by comparing with previous actual results. How do we satisfy ourselves the cash flow forecasts are reasonable if we cannot check against the actual cash flow achieved?

The quality of monthly management accounts varies considerably between organisations. They often don't exist in small businesses. In larger businesses some are more accurate than others. Accurate monthly accounts requires a considerable effort from the accounting department and within the organisation to ensure all transactions are recorded. The highest approach is to treat each month end like a year end. Where does your organisation fit? The less effort for accuracy, the less reliable the monthly figures. The less reliable the monthly figures the more likely there will be larger differences between the twelve month management accounts and the final annual accounts.

There will always be differences between the management accounts and the final accounts due to adjustments that are made only at year end. Typically accruals are more accurately estimated at year end, doubtful debts are finalised, inventory and other asset write-downs and employee liabilities estimated. The more things estimated at year end the greater the difference between the management accounts and the final accounts.

ANALYSING FINANCIAL STATEMENTS

Stages of the analysis:

1 Review the annual report.

2 Enter the financial information in the Excel™ spreadsheet.

3 Analyse performance over time.

(PowerPoint slides used correspond with the above summary of three steps and the following information on reviewing the annual report, the three financial statements and ratios over time.)

The following briefly explains how to perform each stage of the analysis.

1 Review the Annual Report

For Australian public companies the annual report consists of a minimum of directors' report, directors' declaration, auditors' report, income statement, balance sheet, cash flow statement and notes to the accounts. The accounts are regarded as consisting of the directors' declaration, the financial statements and the notes. The auditors give their opinion on these.

2 Enter the Financial Information in the Excel™ Spreadsheet

Analysis should be performed over a minimum of three years, preferably five years or more to meaningfully assess trends. The annual report usually provides only two years. Thus, information from the annual report should be entered in a spreadsheet that accumulates data over time (enabling comparison of the three financial statements) and also calculates ratios for analysis.

The following pages containing financial statement and ratio information are taken from an adapted Excel™ spreadsheet master for analysing not-for-profit organisations.

3 Analyse Performance Over Time

The approach here is built on the information provided in the spreadsheet used in this workshop.

Analysis of Profit Performance

- Trend in revenue and expenses, particularly major items
- Noting any unusual items and their nature
- Trend in surplus before and after interest expense

Analysis of Cash Flow Performance

- Strength of net operating cash flows
- Evidence of self-generation: net operating cash flow pays for acquisition of property, plant and equipment in years of normal activity (under investing)
- Ability to handle borrowings through payment of interest within the operating cash flows and repayment of principal from the operating cash flows

Analysis of Balance Sheet Performance

- Trend in total assets. Which assets have caused most of the change?
- Trend in liabilities. Which liabilities have caused most of change?
- Changes in level of and elements of equity

Analysis of Ratios

- Trend in liquidity – current ratio
- Trend in management efficiency – revenue to assets ratio
- Trend in financing ratios – interest cover and liabilities to equity
- Trend in profitability ratios – surplus to revenue, assets and equity
- Change in size as measured by revenue and assets