

A close-up photograph of a person in a grey suit and tie, sitting at a desk. They are holding a large, light-brown folder or document. In the foreground, there is a laptop and several sheets of paper with colorful bar and pie charts, suggesting a financial or business context. The background is slightly blurred.

Demystifying Financial Statements

September 2017

What we'll cover today

1. Learn about the **different types of financial statements**
2. Learn **not all financial statements are prepared on the same basis**
3. Identify the **four primary financial statements** in a financial report and their purpose
4. **Practical examples** of financial statements and how to read them
5. **Additional information** found in financial statements

Types of financial statements

General Purpose Financial Statements

Comply with **all accounting standards** and are required where reporting entity has users who rely on financial statements to make decisions about the allocation of their resources

Special Purpose Financial Statements

Comply with a **minimum number of standards**

Reduced Disclosure Regime (RDR) General Purpose Financial Statements

Have **same compliance requirements** with respect to measurement principles as general purposes but **less disclosure**

Not all financial statements are the same

Accrual Accounting

- Recognises revenue and expenses **as they are earned/incurred**
- Recognises **receivables and payables**

Cash Accounting

- Recognises revenue and expenses **when cash is received or paid**
- **No record of assets and liabilities**

For the purposes of this presentation, accrual accounting has been used.

Primary financial statements

Primary financial statements

Income statement

Reports performance over the year by listing revenue and expenses.

Balance sheet

Lists assets, liabilities and owners equity at a point in time.

Statement of changes in equity

Shows change in owners' equity for a specific period of time.

Cash Flow statement

Details how changes in the balance sheet and income statement impact the organisation's cash and cash equivalents. The statement is divided into operating, investment and financing activities.

Accounting policies

Describes how transactions are recognised and measured.

Notes to the financial statements

Provides further detail on items included in the primary financial statements.

Example: Income statement

For the year ended 31 December X1

	Notes	X1 \$'000	X0 \$'000
Revenue			
Revenue from operating activities	4	16,857,976	15,040,834
Total revenue		16,857,976	15,040,834
Net gain/(loss) on sale of property, plant and equipment		3,076	1,857
Research		(1,242,737)	(1,216,715)
Health programs (including those funded by grants)		(3,273,281)	(3,467,097)
Fundraising		(3,719,042)	(3,938,813)
Cost of goods sold		(264)	(576)
Communications and publicity		(275,484)	(209,107)
Administration		(260,527)	(204,222)
Results from Operating activities		8,089,717	6,006,161
Finance income		63,385	85,060
Finance costs		(665)	-
Net finance income	6	62,720	85,060
Net surplus before grants to head office		8,152,437	6,091,221
Net grants to head office	18	(8,539,425)	(5,941,041)
(Deficit)/surplus for the year before tax		(386,988)	150,180
Income tax expense	3	-	-
(Deficit)/surplus for the year after tax		(386,988)	150,180
Total other comprehensive income		-	-
Total comprehensive (deficit)/income for the year		(386,988)	150,180

- One-offs
- Are we valuing PPE correctly?

Example: Balance sheet

For the year ended X1

	Notes	X1 \$'000	X0 \$'000	
Assets				
Current assets				
Cash and cash equivalents	7a	2,678,434	4,752,378	
Trade and other receivables	8	604,080	390,306	Are these performing or in arrears?
Total current assets		3,282,514	5,142,684	
Non-current assets				
Property, plant, equipment and vehicles	9	321,111	104,883	Are these valued appropriately?
Total non-current assets		321,111	104,883	
Total assets		3,603,625	5,247,567	
Liabilities				
Current liabilities				
Trade and other payables	10	770,734	1,490,287	
Grants income deferred	11	1,963,052	2,399,254	
Employee benefits	12	401,300	393,976	
Provisions	16	61,770	123,541	
Total current liabilities		3,196,856	4,407,058	
Non-current liabilities				
Employee benefits	12	38,013	30,813	
Provisions	16	268,422	322,374	
Total non-current liabilities		306,435	353,187	
Total liabilities		3,503,291	4,760,245	
Net assets		100,334	487,322	
Equity				
Reserves	13	533,817	324,857	
Retained earnings		(433,483)	162,465	Accumulated loss/insolvency concerns
Total equity		100,334	487,322	

Example: Statement of changes in equity

For the year ended X1

	Reserves \$'000	Accumulated Surplus \$'000	Total Equity \$'000
Balance of accumulated surplus as at X1	-	337,142	337,142
Comprehensive income for the period	-	-	-
Surplus	-	150,180	150,180
Transfers to reserves	324,857	(324,857)	-
Other comprehensive income	-	-	-
Total comprehensive income for the periods	324,857	(174,677)	150,180
Balance of accumulated surplus as at X0	324,857	162,465	487,322
Balance of accumulated surplus as at X0	324,857	162,465	487,322
Comprehensive income for the period			
(Deficit)	-	(386,988)	(386,988)
Transfers to reserves	208,960	(208,960)	-
Other comprehensive income	-	-	-
Total comprehensive income for the periods	208,960	(595,948)	(386,988)
Balance of accumulated surplus as at X1	533,817	(433,483)	100,334

What is driving this? Are Retained Profits being quarantined?

Solvency pressure

Example: Statement of cash flow

For the year ended X1

	Notes	X1 \$'000	X0 \$'000
Cash flows from operating activities			
Cash receipts in the course of operations		15,002,568	14,516,411
Cash payments in the course of operations		(6,232,656)	(6,307,757)
Net grants made to head office		(10,955,484)	(7,991,598)
Net financial income		111,186	127,275
Net cash from operating activities	7b	(2,074,386)	344,331
Cash flows from investing activities			
Proceeds from sale of property, equipment and vehicles		15,600	22,500
Acquisition of property, equipment, vehicles and computer software		(15,158)	(5,250)
Net cash from investing activities		442	17,250
Net (decrease)/increase in cash and cash equivalents		(2,073,944)	361,581
Cash and cash equivalents at 1 January		4,752,378	4,390,797
Cash and cash equivalents at 31 December	7a	2,678,434	4,752,378

Is this a concern relative to cash reserves?

Example: Accounts policies & notes to the financial statements

The accounting policies and other notes to the financial statement provide additional information pertaining to an organisation's operations and financial position and are considered to be an integral part of the financial statements.

(iv) Grants for health programs and research (deferred income)

Grants received for specific health programs or research are recognised as income only to the extent of work completed on those projects. Any funds attributable to work still to be completed are carried forward as grants income deferred as recognised in note 11. In the circumstances where the terms of the grants stipulate that any unexpended funds are to be returned to the sponsor these unexpended funds are held as deferred income until such time as they are returned to the funding body.

Important to understand how percentage of work completion is measured.

Example: Accounting policies & notes to the financial statements (cont.)

Need to review for reasonableness

(d) Property, plant, equipment and vehicles

(i) Recognition and measurement

Items of property, plant, equipment and vehicles are measured **at cost** less accumulated depreciation and impairment losses (refer to note 3(i)(ii)). Cost includes expenditure directly attributable to the acquisition of the asset. Such assets are recognised/derecognised by the Foundation on the date it commits to purchase/sell each item. Gains and losses on disposal of an item of property, plant, equipment and vehicles, are determined by comparing the proceeds from the disposal with the carrying amount of property, plant, equipment and vehicles and are recognised on a net basis in the Statement of Surplus or Deficit and Other Comprehensive Income.

NB: Can be different to fair value and generate impairment pressure

(ii) Depreciation

Depreciation is charged to the Statement of Surplus or Deficit and Other Comprehensive Income on a straight-line basis over the estimated useful lives of each item of property, plant, equipment and vehicles from the date they are acquired and are ready for use. Land is not depreciated. The estimated useful lives in the current and comparative periods are as follows:

- buildings
- leasehold improvements
- office furniture and equipment
- motor vehicles

40 years
Term of Lease
3 – 10 years
6 – 7 years

Depreciation methods, remaining useful lives and the residual values of individual assets, if not insignificant, are reviewed at each reporting date.

Example: Accounting policies & notes to the financial statements (cont.)

(f) Intangible assets

(i) Computer software

Significant items of computer software are stated at cost less accumulated amortisation and impairment losses. Minor expenditure on computer software is expensed as incurred.

(ii) Amortisation

Amortisation is charged to the Statement of Surplus or Deficit and Other Comprehensive Income on a straight-line basis over the estimated useful lives of each item of computer software from the date it is acquired and is ready for use. Estimated useful lives are deemed to be 2-3 years. Remaining useful lives are reassessed annually. No residual value is assumed.

Need to confirm for reasonableness

Example: Accounting policies & notes to the financial statements (cont.)

7a. Cash and cash equivalents

How much earns 0.0% interest?

	X1 \$'000	X0 \$'000
Cash and cash equivalents include bank accounts and short term deposits maturing within 90 days paying interest rates of 0.0% to 3.5% (2014: 0.5% to 3.5%)	2,678,434	4,752,378
Total	2,678,434	4,752,378

9. Property, plant, equipment and vehicles

Cost	Computers	Leasehold Improvements	Motor Vehicles	Office Equipment	Furniture & Fittings	Buildings	Software	Totals
Balance b/f	312,362	1,802,599	106,448	209,052	48,955	-	22,182	2,501,598
Additions	-	-	15,158	-	-	267,000	-	282,158
Disposal	(5,323)	-	(36,860)	-	-	-	-	(42,183)
Balance c/f	307,039	1,802,599	84,746	209,052	48,955	267,000	22,182	2,741,573

Accumulated depreciation	Computers	Leasehold Improvements	Motor Vehicles	Office Equipment	Furniture & Fittings	Buildings	Software	Totals
Balance b/f	307,679	1,762,840	68,140	199,814	36,060	-	22,182	2,396,715
Depreciation change for year	3,791	28,803	12,508	2,728	5,577	-	-	53,407
Disposal	(4,832)	-	(24,828)	-	-	-	-	(29,660)
Balance c/f	306,638	1,791,643	55,820	202,542	41,637	-	22,182	2,420,462
NBV X1	401	10,956	28,926	6,510	7,318	267,000	-	321,111
NBV X0	4,683	39,759	38,308	9,238	12,895	-	-	104,883

What did we buy?

Example: Accounting policies & notes to the financial statements (cont.)

11. Grants income deferred

	X1 \$'000	X0 \$'000
Balance at 1 January	2,399,254	2,671,898
Amounts received	1,207,012	1,627,596
Income taken to revenue	(1,643,214)	(1,900,240)
Balance at 31 December	1,963,052	2,399,254

Is this drop a concern?

16. Provisions

Obligations arising as a result of the Foundation's adherence with the prescribed treatment of leases outlined in the accounting standards are shown as follows:

Cost	Office lease incentives deferred	Make good of leased premises	Total \$'000
Balance at 1 January	185,311	260,604	445,915
Future obligations incurred	-	-	-
Lease Incentives received	-	-	-
Incentives offset against lease rental expense	(123,541)	-	(123,541)
Expenditure recognised in the Statements of Surplus or Deficit and Other			
Comprehensive Income	-	7,818	7,818
Balance at 31 December	61,770	268,422	330,192
Current	61,770	-	61,770
Non-Current		268,422	268,422
Total	61,770	268,422	330,192

Is this sufficient?

Example: Accounting policies & notes to the financial statements (cont.)

20. Financial instruments

Impairment losses from trade receivables

The movement in the allowance for impairment in respect of trade receivables during the year was as follows:

	X1 \$'000	X0 \$'000
Balance at 1 January of provision for doubtful debts	-	7,055
Realisation of impairment (loss)/recovery previously provided for	-	(2,096)
Impairment loss/(recovery) recognised in Surplus/(Deficit)	-	(4,959)
Balance at 31 December of provision for doubtful debts	-	-

- What happened?
- Is there a risk this period?

Of the foundations trade receivables balance of \$440,000, \$0 is past due (X0, \$0)

Based on receivables history, the Foundation believes that no further impairment allowance is necessary in respect of trade receivables, as trade and other receivables predominately relate to inter divisional accounts and grants income accrued.

Example: Accounting policies & notes to the financial statements (cont.)

20. Financial instruments

	X1					X0				
	Carrying Amount/ Face Value \$'000	-1%		+1%		Carrying Amount/ Market Price \$'000	-1%		+1%	
Surplus/ (Deficit) \$'000		Equity \$'000	Surplus/ (Deficit) \$'000	Equity \$'000	Surplus/ (Deficit) \$'000		Equity \$'000	Surplus/ (Deficit) \$'000	Equity \$'000	
Interest rate risk										
Financial assets										
Fixed rate instruments										
Term deposits-maturing within 90 days	2,000,000	(20,000)	(20,000)	20,000	20,000	4,150,000	(41,500)	(41,500)	41,500	41,500
Term deposits-maturing beyond 90 days	-	-	-	-	-	-	-	-	-	-
Variable rate instruments										
Cash at bank	154,076	(1,541)	(1,541)	1,541	1,541	161,300	(1,613)	(1,613)	1,613	1,613
Cash call accounts	524,358	(5,244)	(5,244)	5,244	5,244	441,078	(4,411)	(4,411)	4,411	4,411
Total increase/(decrease)		(26,785)	(26,785)	26,785	26,785		(47,524)	(47,524)	47,524	47,524

- Should we hedge?
- Do we think rates will go up or down?

Audit reports

Audit Reports can provide **further insight into an organisation's financial statements and its sustainability/solvency.**

You should keep a watch out for a **qualified vs unqualified opinion.**

Auditors are required to provide an opinion on the financial statements.

Generally a clean or unqualified opinion is a good sign however where an audit opinion is qualified, adverse or comes with an emphasis of matter it is important to understand why the auditor has modified their opinion and consider the implications for the organisation including:



- Is the company facing **solvency issues**?
- Can the financial statements be **relied upon**?
- Is it merely a **standard qualification** due to the nature of the organisation's operations (ie auditor could not gain comfort due to inadequate controls over donations collection process)?

Important Information

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