

Financial Reporting For NPOs

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Objectives



Financial Reporting standards – NPOs perspective



Accounting policies, Chart of accounts and Finance Manual for NPOs



Interpretation of financial statements for NPOs

Regulatory Background

IFRSs



International financial reporting standards are developed by IASB.

They encompass IFRSs and IASs

IPSAS



International Public Sector Accounting Standards (IPSAS) are issued by the International Public Sector Accounting Standards Board (IPSASB).

IPSAS applies to all public sector entities

IFRS for SMEs



On 9 July 2009, the IASB issued the IFRS for SMEs. This is developed specifically for small and medium-sized entities (SMEs).

Financial Reporting



This describes the systems and procedures used to keep track of financial and monetary transactions which take place inside an organization. Financial accounting is a system of recording, classifying and summarizing information for various purposes.

Accounting system



Actual system adopted will depend on:

- the expertise and resources available;
- the volume and type of transactions;
- reporting requirements of managers;
- obligations to donors; and
- the communities NGOs work with.

The Right System?



Every NGO is different – there is no such thing as a ‘model’ finance system. So there are a number of considerations to take into account to find the right approach for your NGO:

The Chart of Accounts

This is a list of pre-determined categories of accounts employed by a specific entity

These Accounts are listed in the Chart of Accounts and are typically arranged in a logical order:
Income and Expenditure, Assets (things we own) and Liabilities (things we owe).

Financial Policies and Procedures

- A policy sets out a set of principles and guidelines for a key area of activity within an organization.
- It removes any questions about how important resources are used.
- For example, a Vehicle Policy will clarify who can drive the NGO's vehicles, how they are disposed of and rule on private usage by staff.

What is a Finance Manual?

The Finance Manual brings the financial policies and procedures all together in one document. The manual may also be known as the Financial Regulations or Finance and Office Procedures.



What goes in a Finance Manual?

- Financial accounting routines
- The Chart of Accounts and cost centre codes
- Delegated authority rules (ie who can do what)
- The budget planning and management process
- Ordering and purchasing procedures
- Bank and cash handling procedures



Standard Forms

Standard forms are purpose-designed documents used to simplify or facilitate financial and administration routines



Some typical uses for standard forms:

- Payment Voucher
- Purchase Order
- Travel and Subsistence Expenses claim
- Assets Register
- Vehicle Log
- Bank Reconciliation
- Journal Voucher
- Staff loan application



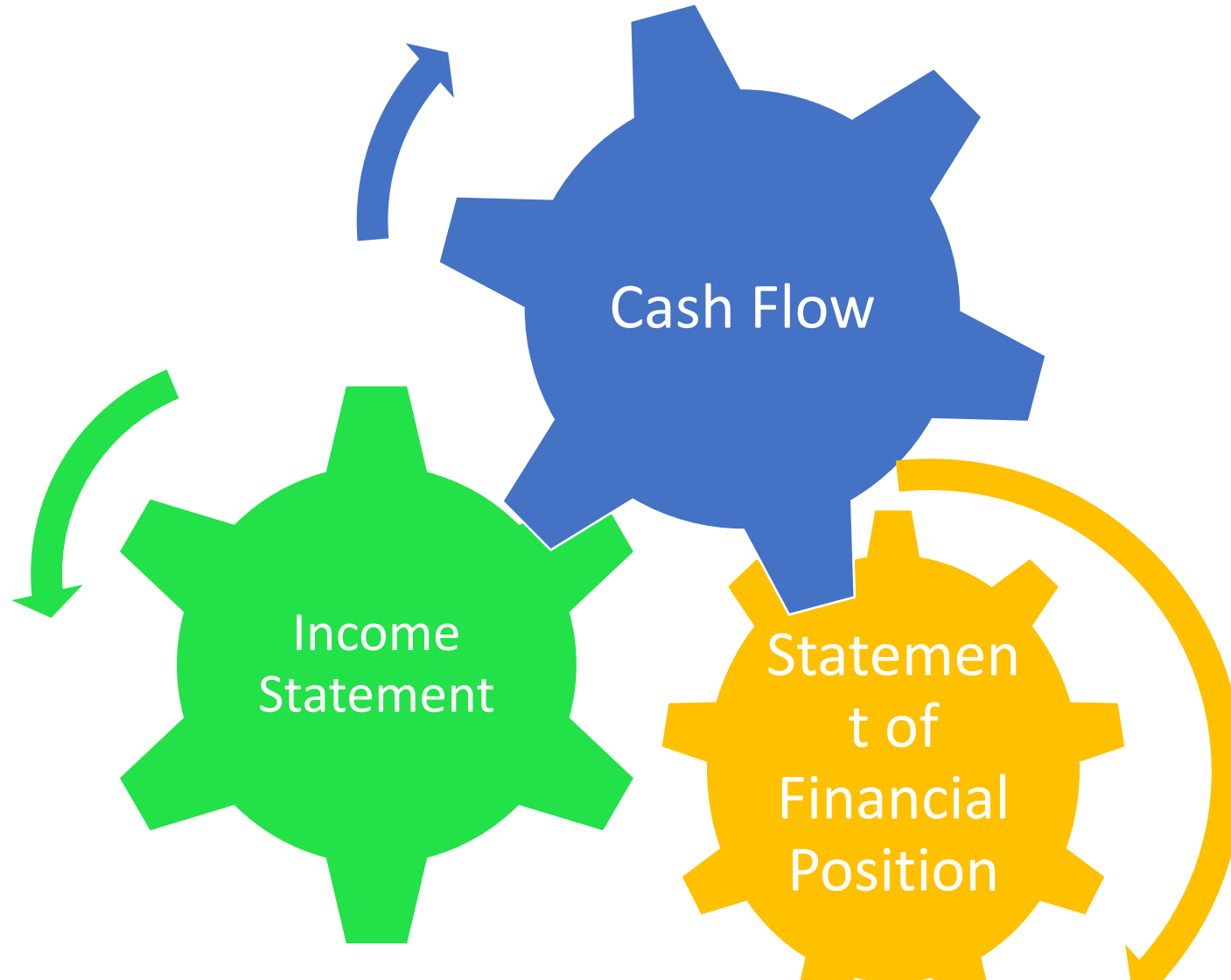
Financial Statements



Also referred to as final accounts these are the reports in the accounting cycle. They include

- ❖ Income statement or statement of comprehensive income/ Income and expenditure
- ❖ Statement of financial position

Three Key Financial Statements



- ❖ Statement of cash-flows
- ❖ Statement of net assets
- ❖ Statement of budgetary comparison
- ❖ Notes to financial statements

The Trustees (Directors) Report

- Explains financial performance
- Puts into context activities /achievements against plans and objectives set
- Outlines plans for the future

Environmental Reports

Social Responsibility Reports



Key Considerations of Financial Reporting

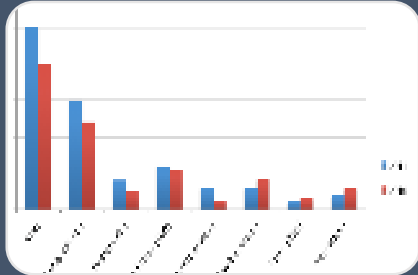
- Proper documentation in the files to support all information reported in financial report.
- All financial reports should be based on the organization's accounting system.
- There should be a review and reconciliation of the information to ensure accuracy

Making sense (& use) of financial statements



- After generating financial statements
 - By the way, you should be doing this on a monthly, quarterly, and yearly basis
- Now what?
- You have a lot of powerful information in your hands. The question now is how to understand it & use it

Making sense (& use) of financial statements



Trend Analysis

Financial ratios	
Current ratio	1 Total debt to assets
1.86	8.23
1.14	20.57

Ratio Analysis

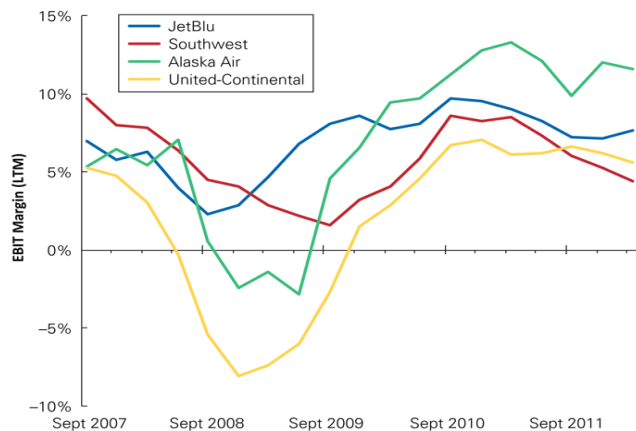
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	Plan	2001 Actual
REVENUE		
net sales	\$4,771,500	\$4,000,000
Less returns and allowances	95,432	220,000
net Sales	\$4,676,068	\$4,780,000
COST OF SALES		
total Cost of Goods Sold	\$3,500,000	\$3,000,000
gross Profit (Loss)	\$1,176,068	\$1,780,000

Variance Analysis: Projected vs. Actual

Trend Analysis

- Examine changes in specific accounts (or totals) from period to period



2 Types

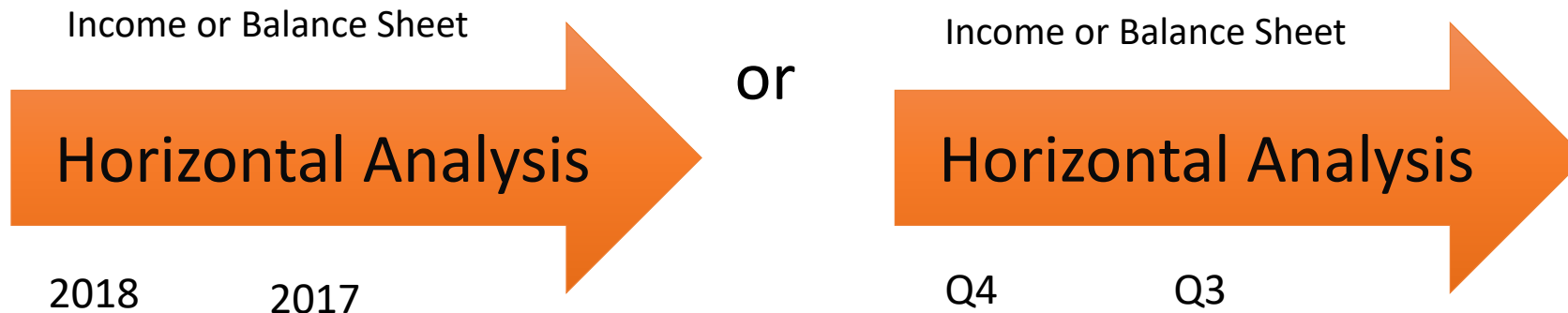
Horizontal Analysis

Vertical Analysis

Trend Analysis: Horizontal



- Let's start with horizontal analysis
- First why do we do it?
 - Well it helps us see changes in financial statement items over a period of time, which allows us to recognize trends
- Do it for the income statement & the balance sheet



Trend Analysis: Horizontal

- Absolute Change = (Current Period – Base Period)
- % Change = (Current Period – Base Period) / Base Period

	2018	2017	\$ Change	% Change
Revenue	1,875,000	1,812,500	62,500	3%
COGS	1,031,250	996,875	34,375	3%
Gross Profit	843,750	815,625	28,125	3%
Operating Expenses				
SG&A	251,460	242,700	8,760	4%
Depreciation	110,000	110,000	0	0%
Amortization	0	0	0	
Total Operating Expenses	361,460	352,700	8,760	2%
Operating Profit	482,290	462,925	19,365	4%
Interest Expense	35,000	40,000	-5,000	-13%
Income before taxes	447,290	422,925	24,365	6%
Taxes	166,170	157,119	9,052	6%
Net Income	281,120	265,806	15,313	6%

Trend Analysis: Horizontal - Example

Horizontal Analysis Income statement for Q1 and Q2

	Q2	Q1	Ksh Change	% Change
Revenue	15,000,000	11,000,000	4,000,000	36%
COGS				
Variable	9,000,000	6,600,000	2,400,000	36%
Fixed				
Factory Salaries	216,000	216,000	-	0%
Factory Rent	750,000	750,000	-	0%
Total Fixed	966,000	966,000	-	0%
Total COGS	9,966,000	7,566,000	2,400,000	32%
Gross Profit	5,034,000	3,434,000	1,600,000	47%

Conclusions



Revenue is up 36%!

Look's like we have a sustainable model, at least with these operating expenses – that translated into a 67% bump in operating profit & 75% bump in net surplus!

Trend Analysis: Horizontal

	Q2	Q1	Ksh Change	% Change
Assets				
Current Assets				
Cash	2,248,852	114,426	2,134,425	1865%
Inventory	600,000	600,000	0	0%
AR	1,500,000	1,500,000	0	0%
Fixed Assets				
			0	
PPE	10,000,000	10,000,000	0	0%
Accumulated Depreciation	300,000	150,000	150,000	100%
<hr/>				
Total Assets	14,048,852	12,064,426	1,984,425	16%

Trend Analysis: Horizontal

Liabilities & Owner's Equity

Liabilities

Short-term

AP

0

0

0

-

Long-term

Loan

8,750,002

9,375,001

-624,999

-7%

Total Liabilities

8,750,002

9,375,001

-624,999

-7%

Owner's Equity

Contributed Capital

1,200,000

1,200,000

0

0%

Retained Earnings

4,098,850

1,489,425

2,609,424

175%

Total Equity

5,298,850

2,689,425

2,609,424

97%

Total Liabilities & Equity

14,048,852

12,064,426

1,984,425

16%

Conclusions



That jump in net income caused cash to soar!

Assets are up a solid 16% mostly due to the spike in cash from ops.

This is all translating very well for retained reserves.

Trend Analysis: Vertical Analysis (Common Size)



- First why do we care?
 - Helpful to see relative changes within your business
 - Also it helps you compare your company to others
- So how do you common size financial statements?
 - Income and expenditure – express line items as a percentage of total current year sales
 - Balance Sheet – express line items as a percentage of current year total assets

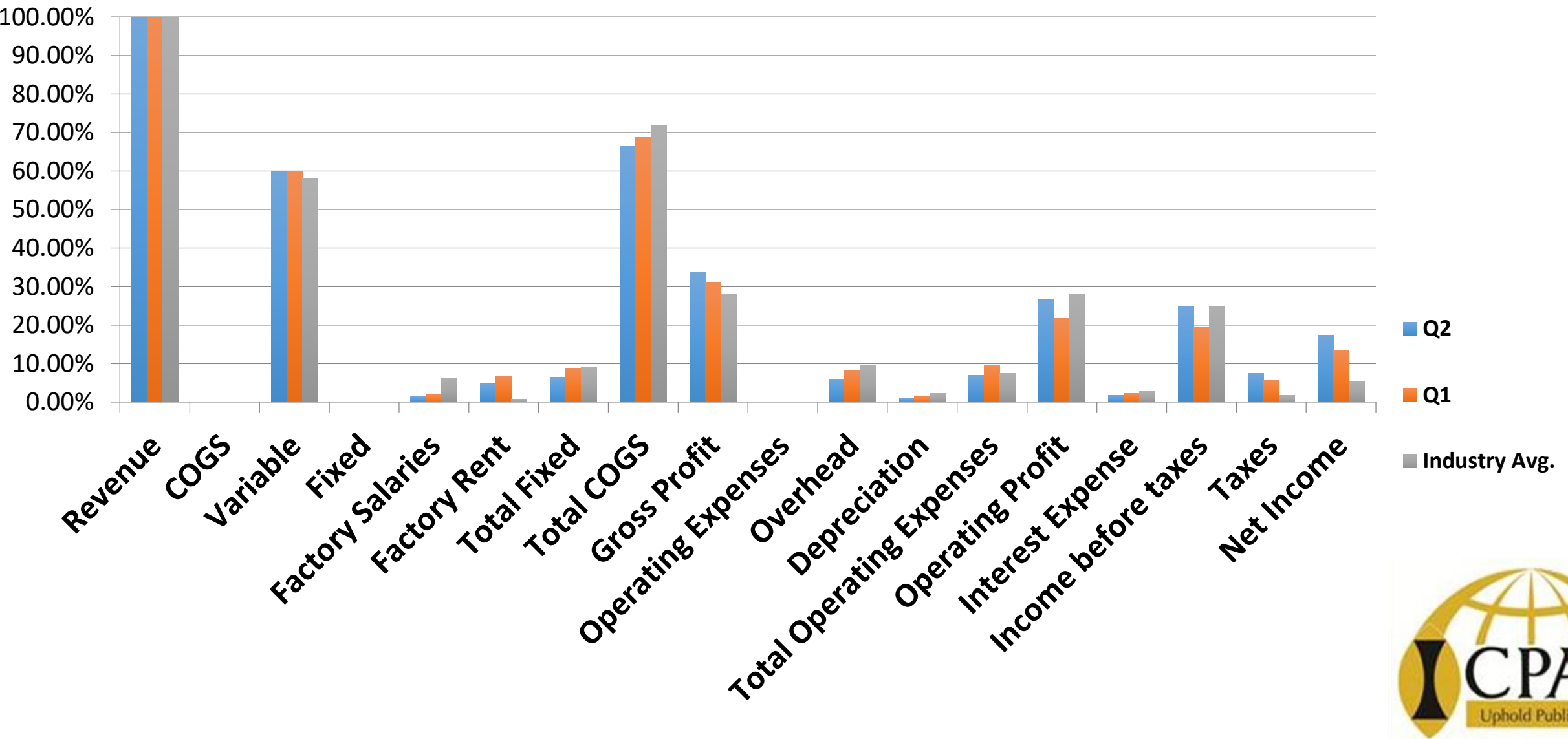
Trend Analysis: Vertical

- Divide each item by the common base of either revenue or total assets
- You can still do this for multiple periods for comparison

	2012		2011	
	Amount	% of Rev.	Amount	% of Rev.
Revenue	1,875,000	100%	1,812,500	100%
COGS	1,031,250	55%	996,875	55%
Gross Profit	843,750	45%	815,625	45%
Operating Expenses				
SG&A	251,460	13%	242,700	13%
Depreciation	110,000	6%	110,000	6%
Amortization	0	0%	0	0%
Total Operating Expenses	361,460	19%	352,700	19%
Operating Profit	482,290	26%	462,925	26%
Interest Expense	35,000	2%	40,000	2%
Income before taxes	447,290	24%	422,925	23%
Taxes	166,170	9%	157,119	9%

Trend Analysis: Vertical → Say it with charts

- Also displaying all of these as graphs is also very helpful in spotting trends.



Ratio Analysis



- What are financial ratios?
 - Quantitative relationships determined from a company's financial information, usually from the financial statements, and used for comparison purposes
 - It is obtained by dividing one financial measurement by another

Ratio Analysis



- Why should you care about them?
 - They provide you with a way to measure progress against predetermined internal goals, certain competitors or the industry as a whole
- You can also identify trends in their early stages & thus have an opportunity to intervene before it's too late!

Ratio Analysis

- You should perform ratio analysis on a least a quarterly basis, but preferably on a monthly basis
- Just like with the operational metrics and the business dashboard, you'll need to customize the set of ratios you track
 - For example, If you have a large number of fixed assets, ratios that measure how efficiently these assets are being used are helpful

Income And Expenditure Ratios

Income Ratios



Reliance Ratio

$$\frac{\text{Largest type of income}}{\text{Total income}}$$

Reliance on a type of income. Awareness of the risk

of a major reduction in income if this type is reduced or stopped. May be helpful for more than one

type of income, including special events.

Reliance on government funding ratio



Total govt grants/contracts

Total income

Awareness of risk in both reliance and autonomy.

Government funding is often closely tied to specific contracts and budgets with limited cost allocations and flexibility.

Earned income ratio



$$\frac{\text{Total earned income}}{\text{Total income}}$$

- Earned income as a percentage of total income
- Organizations with earned income have more autonomy and flexibility.

Self-sufficiency ratio



Total earned income

Total expense

The proportion of operating expenses that are covered by earned income.

EXPENSE AND MANAGEMENT RATIOS



Personnel costs ratio

Total wages, taxes, and benefit expenses

Total expenses

any changes in the percentage of budget total
expenses used for staff is notable

Benefit cost ratio



Total taxes, insurance, and fringe benefits

Total salary and wages

Benefit costs are driven by many external factors and can increase at a different pace than other costs.

Administration cost ratio



Total fundraising, general and admin expense

Total expenses

Non profits should be aware of their ratio and any changes over time

Fundraising efficiency



Contributed income

Fundraising expense

The average dollar amount of contributions raised from each dollar spent on fundraising.

Cost per “unit” of service



Program expense

Units of service

If the nonprofit uses program-based recordkeeping and has an identifiable “unit” of service, this ratio is very helpful in evaluating financial efficiency and identifying any changes over time

Statement of Financial Position



Current Ratio

Current assets

Current liabilities

An indication of the organization's ability to pay current obligations on demand

Daily cash on hand



<u>Annual cash requirement</u>

365

Quick Ratio

<u>Cash and current investments</u>

Current liabilities

A quick test of the operating cash or adequacy

Debt ratio



Total liabilities

Total unrestricted net assets

Accounts Receivable Aging



Accounts receivables more than 90 days old
Total Accounts Receivables

Accounts Payable Aging



Accounts payable more than 90 days old
Total Accounts Receivables

Ratio Analysis: Types of Analysis

- Set targets for ratios internally & measure against those targets
- Look at trends in ratios over time
- Benchmark to see how you're doing
 - Industry Averages
 - Competitors' (if you can get your hands on their financials) for most private companies, this will be tough



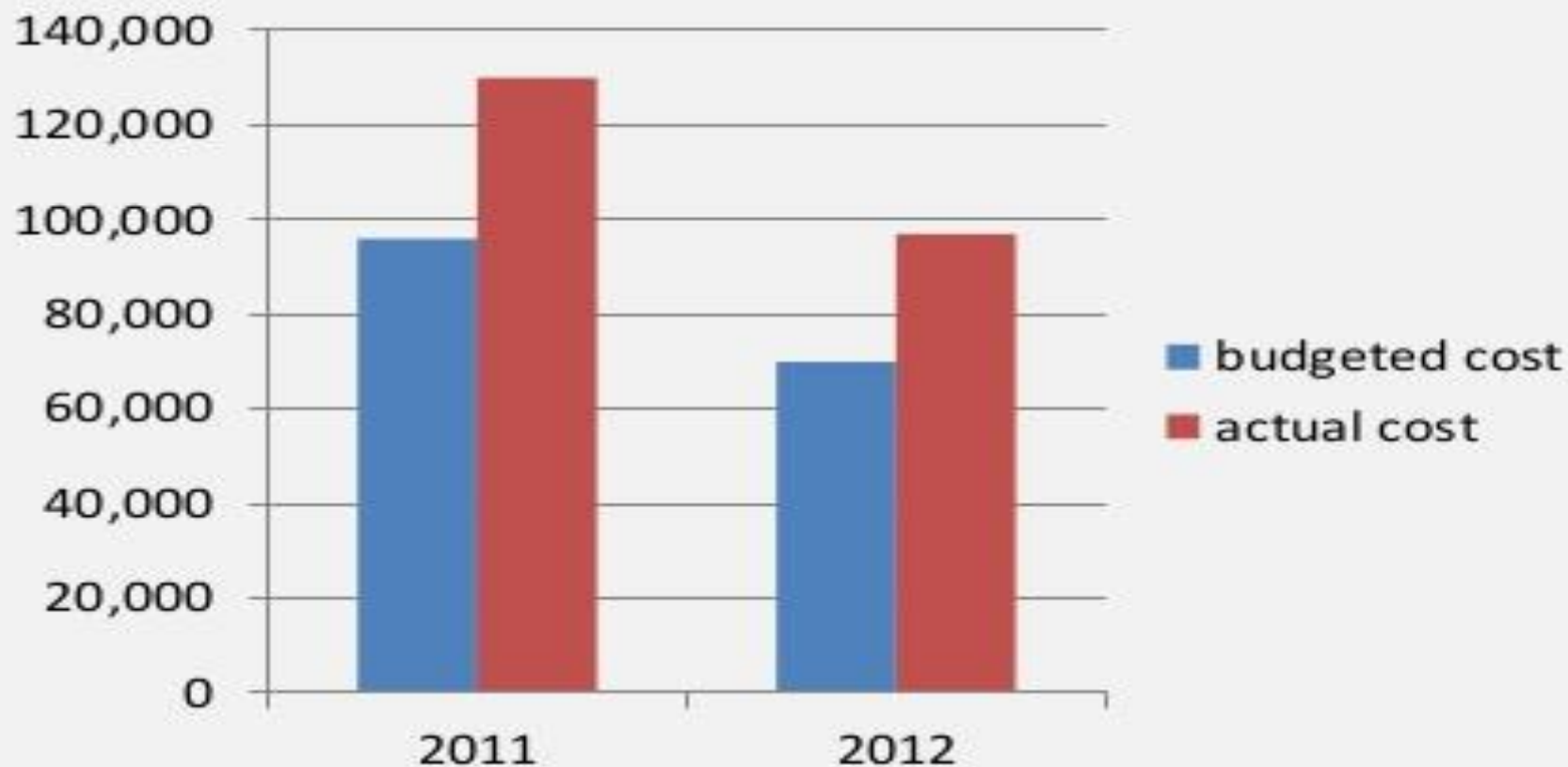
Variance analysis.



- This is the process of analyzing the difference between actual costs compared to planned or budgeted costs.

Use of variance analysis in Business

- Budget vs. Actual Costs



		<u>April</u>		
		Budget	Actual	Variance
	Income	2,500	2,500	0
	Expenses			
	Rent	800	800	0
	Electric	50	50	0
	Heat	90	100	(10)
	Internet	50	50	0
	Phone	50	50	0
	Groceries	200	189	11
	Restaurants	150	192	(42)
	Gas	100	115	(15)
	Entertainment	100	95	5
	Clothing	60	125	(65)
	Travel	50	25	25
	Other	100	98	2
	Total Expenses	1,800	1,889	(89)
	Balance	700	611	89

Variances Conclusion



Variances are either adverse or favourable

Questions & comments

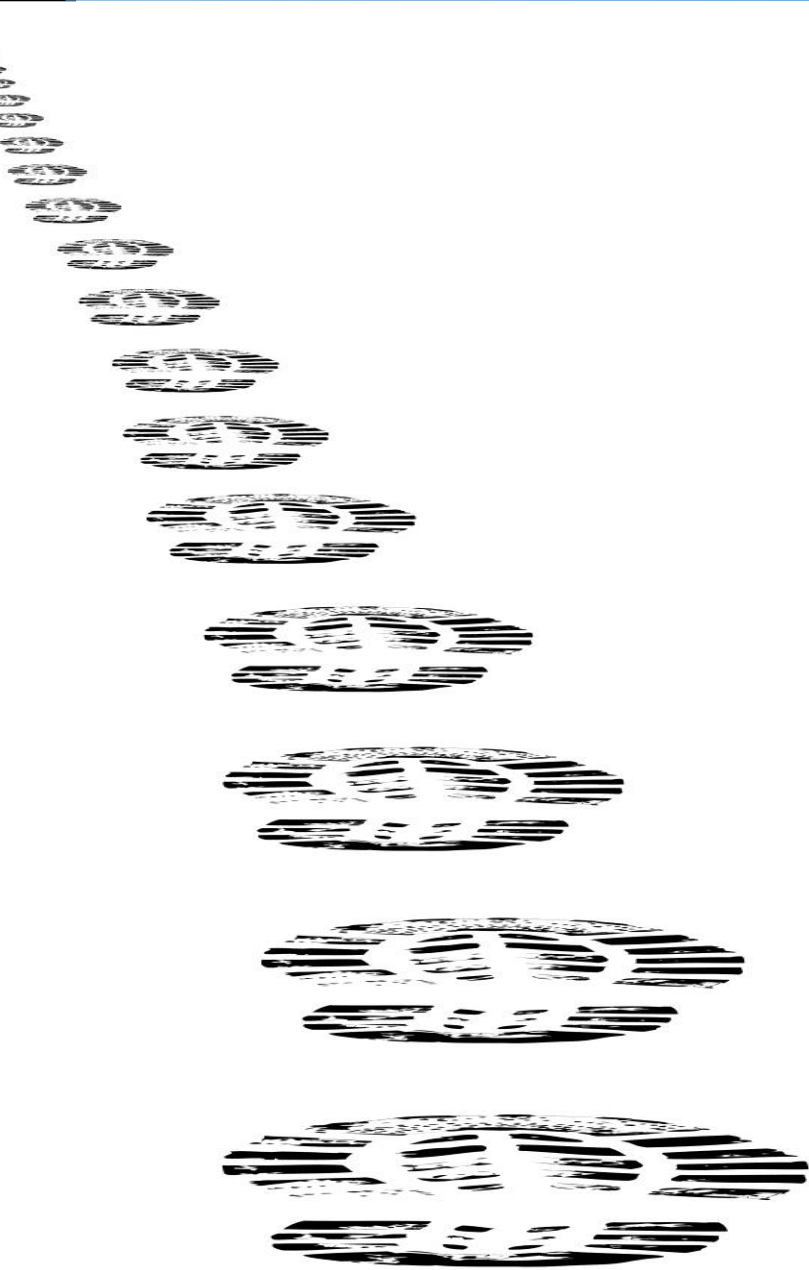




GOD BLESS YOU ALL

The end

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“If a man is called to be a street sweeper, he should sweep streets even as a Michaelangelo painted, or Beethoven composed music or Shakespeare wrote poetry. He should sweep streets so well that all the hosts of heaven and earth will pause to say, 'Here lived a great street sweeper who did his job well.'”