

Accounting for Government and Non-profit Organisations

Unit - III

COURSE CODE – Acct 327

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Unit III

Basic of financial statements,
Issues of Reporting, and Financial Analysis:
Specific objectives of financial reporting,
Supplementary information required for
reporting,
General requirement,

Financial statements

Meaning:

- **Financial statements** (or **financial reports**) are formal records of the financial activities of a business, person, or other entity. Financial statements are often referred to as **accounts**, although the term financial statements is also used, particularly by [accountants](#).
- Financial statements provide an overview of a business or person's financial condition in both short and long term. All the relevant financial information of a business enterprise, presented in a structured manner and in a form easy to understand, are called the financial statements. There are four basic financial statements

Basic of Financial Statements

- **Balance sheet**: also referred to as statement of financial position or condition, reports on a company's assets, liabilities, and Ownership equity at a given point in time.
- **Income statement**: also referred to as Profit and Loss statement (or a "P&L"), reports on a company's income, expenses, and profits over a period of time. Profit & Loss account provide information on the operation of the enterprise. These include sale and the various expenses incurred during the processing state.
- **Statement of retained earnings**: explains the changes in a company's retained earnings over the reporting period.
- **Statement of cash flows**: reports on a company's cash flow activities, particularly its operating, investing and financing activities

Importance & Element Financial Statements

- Creating [financial statements](#) for your company is a critical task that will help you know if your company is growing, shrinking or staying flat. They are necessary for obtaining bank loans, selling your business or finding investors. In addition, analysis of the numbers can also help you grow your revenue by highlighting areas for improvement. There are three basic financial statements:
- Income statement (also known as P&L or profit and loss): shows whether your company is profitable, expressed by "Revenue – Expenses = Profit".
- Balance sheet: a snapshot of the company's assets (property, inventory, cash) versus its liabilities (loans, [accounts payable](#), debt), expressed by "Assets = Liabilities + Shareholders' Equity".
- Cash flow statement: shows where the company's cash is going (to operating activities, investment activities, or financing activities) expressed by "Beginning Cash Balance + Cash Inflows – Cash Outflows = Ending Cash Balance".

Financial Indicators Financial Statement

- There are no reliable ‘rules of thumb.’
- Governments account for operations in different ways. So, some ratios may not be directly comparable.
- Whether a lower or higher ratio is preferred is not always clear.
- Higher or lower ratio depends upon the stage of maturity.
- Ratios are no better than the underlying numbers.

Financial Indicators Financial Statement

- Issue in interpreting financial indicators:
 - Should ratios be based on government-wide, general fund, or a combination of both?
 - It depends on why the measure is being calculated and how it will be interpreted.
- Fiscal effort:
 - Extent to which a government is taking advantage of its fiscal capacity.
 - Fiscal effort = $\frac{\text{Per capita revenue from own sources}}{\text{Median family income}}$ **OR**
 $\frac{\text{Revenue from own sources}}{\text{Total appraised value of property}}$

Financial Reporting

Meaning:

Financial reporting is the process of preparing and distributing financial information to users of such information in various forms. The most common format of formal financial reporting are financial statements. Financial statements are prepared in accordance with rigorously applied standards defined by professional accounting bodies developed according to the legal and professional framework of a specific locale.

Financial Reporting Standards

- **International Financial Reporting Standards (IFRS)** are Standards, Interpretations and the Framework adopted by the [International Accounting Standards Board](#) (IASB).
- Many of the standards forming part of IFRS are known by the older name of **International Accounting Standards (IAS)**. IAS were issued between 1973 and 2001 by the Board of the [International Accounting Standards Committee](#) (IASC).
- On 1 April 2001, the new IASB took over from the IASC the responsibility for setting International Accounting Standards. During its first meeting the new Board adopted existing IAS and SICs. The IASB has continued to develop standards calling the new standards IFRS.

Objectives of Financial Reporting

- Financial reports are the documents and records you put together to track and review how much money your business is making (or not). The purpose of financial reporting is to deliver this information to the lenders and shareowners (the stakeholders) of your business. If someone else is supporting part of your business, financial reporting must be part of the essential contract between you and them. Your lenders and investors have the right to know if their money is being spent wisely and returning a [profit](#).

Objectives

- **What a financial report should accomplish**
- A financial report should answer certain basic financial questions:
- Is the business making a profit or suffering a loss, and how much?
- How do assets stack up against liabilities?
- Where did the business get its capital, and is it making good use of the money?
- What's the cash flow from the profit or loss for the period?
- Did the business reinvest all its profit?
- Does the business have enough capital for future growth?

Reporting Entity

Composition of reporting entity

- One of the least tractable issues
- An organization's legal entity differs from its economic entity.
- Example of common intergovernmental relationships in the US
 - Housing authorities established by cities to provide low cost financing for residents of the cities
 - Turnpike commissions
 - Volunteer fire departments

Criteria for Reporting Entities

This statement established the criteria for determining the units that should be included in a reporting entity.

- Reporting entity should consist of:
 - primary government and
 - component units.
- Primary government: any state government, general purpose local government, or a special purpose state or local government.
- Special purpose government must:
 - Have a separately elected governing body
 - Be legally separate from primary government and be fiscally independent of other governments
 - Have authority to determine its budget, levy taxes, and issue bonds.

(Cont'd)

- **Component Unit:**

- Legally separate government

- Elected officials of primary government are financially accountable

- Exclusion of component unit might cause the primary government's statements to be misleading.

- **Illustration 1:** State of New York established Municipal Assistance Corporation to help the City of New York during financial difficulties.

- **Illustration 2:** For reporting purposes, the City of Houston considers a component unit to be major if assets, liabilities, revenues or expenses exceed

- 10% of that component unit's class and
 - 5% of all component units combined.

Criteria for Reporting Entities (Cont'd)

- Key criteria as to whether a primary government is financially accountable for another government:
 - The primary government appoints a voting majority of the unit's governing body **(or)**
 - A majority of the unit's governing body is composed of primary government officials.
- In addition, either one of the following criteria must be satisfied.
 - The primary government is able to *impose its will* upon the potential component unit.
 - The component unit is able to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

Criteria for Reporting Entities (Cont'd)

- General Rule:
 - A component unit is fiscally accountable only if the primary government controls the appointment of its governing board.
- Exception:
 - If a component unit is fiscally dependent on the primary government, it is fiscally accountable even if its governing bodies are not appointed by the primary government.

Financial reporting Requirements

- **Financial reporting and disclosure requirements**
- Prepare annual financial statements according to a [financial reporting standard](#), have them audited, and to register or publish them
- Prepare more frequent financial disclosures, e.g. Quarterly Disclosure Statements
- Have directors of the bank attest to the accuracy of such financial disclosures
- Prepare and have registered [prospectuses](#) detailing the terms of securities it issues (e.g. deposits), and the relevant facts that will enable investors to better assess the level and type of financial risks in investing in those securities.

Supplementary Requirement

The government are required to incorporate statistical data and information that supplement the basic financial statement, this includes:

1. Individual Statements and Schedules
2. Detail of Actual Valuations
3. Assess the types of Assets
4. Budget and Actual Comparison

General Requirement

- Financial Trends
- Revenue Capacity
- Debt Capacity
- Demographic and Economic
- Operating; volume and usage

Quiz - 3

Multiple choice:

1. Financial statement is prepared to know

(a) Profit (b) The value of assets (c) The value of assets (D) Errors

2. The statement of assets and liabilities is?

(a) Profit and loss (b) Trial balance (c) Financial statement (d) None of the above

3. Financial reporting is the process of preparing and distributing financial information to whom.

(a) Different users (b) Only for organizational purpose (c) Only for the governments (d) None of theses

4. Financial statement is generally prepared

(a) At the end of every year (b) At the end of calendar year (c) At the end of accounting year

5. Financial report are used primarily to

(a) To know the liabilities (b) To know the profitability only (c) Assess financial condition and results of operations (d) None of the above

True OR False:

6. Statement of retained earning is not the part of Financial Statement;

i) True

ii) False

7. Is IFRS provide the reporting standard?

(a) False (b) True

8. Q. Financial Trends is not a part of general requirement.

a) False

b) True

Fill in the blanks:

9. International Financial Reporting Standards (IFRS) are Standards, Interpretations and the Framework adopted by theIASB.....

10. IFRS comes under the regulation of International Accounting Standard board

(a) True (b) False

11. How do..... stack up against liabilities

HOME ASSIGNMENT

Q-1.

Specify the objectives of financial reporting

Q-2.

Explain the supplementary and general information required for reporting

Questions

True and False:

Q. Financial statements provide an overview of a business.

a) True

b) False

Q. Operating and volume of usage is the part of general requirement.

a) False

b) True

Q. Financial Trends is not a part of general requirement.

a) False

b) True

Questions

Q. Supplementary Requirement for reporting include:

- a) **Assess the types of Assets**
- b) Assess the only current assets
- c) Assess only the liabilities
- d) Only Reserves

Q. International Financial Reporting Standards (IFRS)

- a) **International Accounting Standard Board**
- b) AICPA (American Institute of Certified Public Accountant)
- c) AASB (Australian Accounting Standard Board)

Questions

Short answer questions:

Q. Explain the objectives of Financial Reporting

Q. Highlight the points are required for Financial reporting.

Q. Examine Financial Reporting Standards adopted in reporting

Q. What do you mean by financial statements? Explain

Q. What are the objectives of financial reporting?