Financial Accounting Terms

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Financial Reporting – Purpose and Importance

- **Managing Finances -** Making sure we have sufficient income to cover our expenses
- **Accountability and Transparency -** Reporting to funders, leaders, and community members how funding was spent
- **Performance measurement -** Showing progress in achieving program goals

Financial Reporting – Form and Content

- Two main financial statements – income statement (also referred to as profit and loss and statement of operations) and balance sheet
- Income statement shows our income (also called revenue), expenses and profit or loss (surplus/deficit or net income/loss) for a specific period of time
- Balance sheet is a statement of net worth. It shows assets (what we own), liabilities (debt, what we owe) and the net worth (assets minus liabilities) at a specific date
- Financial statements tell a story
- Bank and credit card statements can be summarized into financial statements
- Example of income statement and balance sheet

Financial Reporting for the Past and Future

- Financial statements for a past period are used for accountability and program performance reporting

- Financial statements for a future period - budgets and forecasts. They are used for planning, financial management and funding applications

Financial Reporting Basis – Cash vs Accrual

Cash Basis

- This is how most of us manage finances at home
- Income and expenses are viewed as such when actually received or paid
- Cash basis is used to manage finances and prepare budgets
- We want to make sure we have enough cash to make all the payments
- There’s no timing difference between commitment and payment

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Accrual Basis

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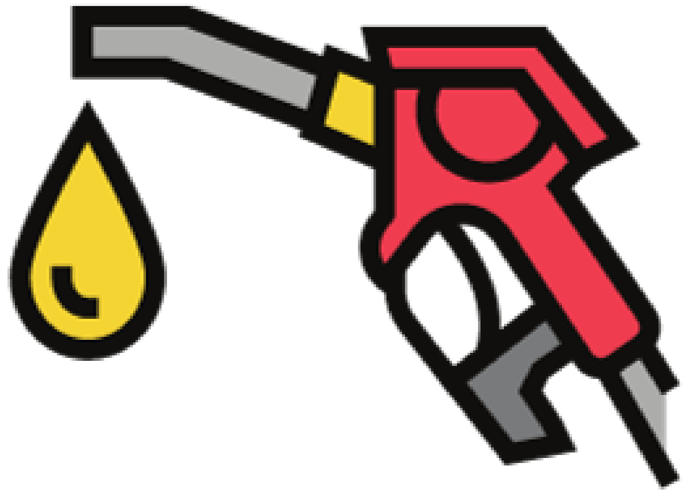
Cash vs Accrual Basis Example

A Band Store sells gas to their local school for $2,500.
The school gets a bill and pays it in 30 days.



Cash Basis

Neither the band or the school will record income or expense at the time of the sale because cash didn’t flow. When the school pays in 30 days, the band will record revenue (income) of $2,500 and the school will record $2,500 in gas expenses.

Accrual Basis

Store: At the time of the sale, the store will record revenue of $2,500 because it has supplied the gas and is legally entitled to receive payment. The Band Store will also record $2,500 owing from the school (account receivable, asset on the balance sheet) until a payment is received.

Local School: The school will record gas expense of $2,500 upon receiving a fuel bill from the store. The school is legally obligated to pay for the fuel as soon as it was received. The school will also record an amount owing to the store of $2,500 (account payable, liability/debt on the balance sheet).

Payment: The store will apply the payment to reduce the account owing from the school, and the school will reduce the amount owing to the store by the payment.

Store Income Statement Under Cash Basis

	$
Revenue	-
Cost of Gas	2,300
Loss	- 2,300

Cash basis is still important for managing our cash flow

Store Income Statement Under Accrual Basis

	$
Revenue	2,500
Cost of Gas	2,300
Profit	200

Accrual basis is more accurate for assessing the store's profitability and allows us to match the timing of income and expenses

Expenses vs Assets

- Costs needed to earn the income and occurring on a regular basis are expenses. Example: wages, utilities, rent, program supplies, cost of goods sold (fuel at a gas station, groceries at a convenience store).
- When we buy something major that will be used longer than one year we consider it an asset, not an expense. Examples: cars, buildings, furniture and equipment, investing in a business.
- In accrual basis of reporting - expenses reduce our profit, assets don't because they're considered an investment, not an expense.
- The aging of purchased assets is financially recognized through recording a portion of their overall cost as depreciation (or amortization) expense every year.
- Depreciation example – computer with a cost of $1,800 is recorded as an asset when bought, no reduction to profit. Since computer is only good for 3 years, we will record a depreciation expense of $600 ($1,800/3 years) in year 1, 2 and 3. Effectively, we're splitting the cost of the computer over 3 years because this is how long it will be used for.
- Depreciation is not a cash expense, we're not actually making a payment for it, therefore we don't use depreciation in cash basis accounting.

Practical Application for First Nations Finance

Thank you for your time

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