SI 626 - Management of Libraries and Information Services, Winter 2009

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http://hdl.handle.net/2027.42/64953
Overview

• Financial statements.
• Analysis of financial statements.
• Measuring organizational performance.
• Conclusion.
Financial statements

• Learning Objectives

  – To develop an understanding of the principles of financial reporting.

  – To develop skills in the analysis of financial statements.

  – To promote critical thinking and reflexivity about the practice of financial reporting.
Financial statements

- Governed by Generally Accepted Accounting Principles (GAAP)
- Non-profit accounting standards set by:
  Financial Accounting Standards Board;
  Governmental Accounting Standards Board;
  Federal Accounting Standards Board
Financial statements

- Types of financial statements:
  - Operating statement
    - Statement of activities.
    - Relates to operating budget.
  - Balance sheet
    - Statement of financial position.
  - Cash flow statement
    - Statement of cash inflows and outflows between two dates.
Financial statements

• Operating statement
  – Activities tracked as resources received and spent.
  – How organization’s net assets have changed over time.

  – Change in net assets: Revenues – Expenses

• Reflects a “surplus” or “deficit”
Financial statements

• Operating statement
  – Revenues and expenses tracked according to classification/fund type.
  – Depends on donor intent.
  – Fund types:
    • Unrestricted
    • Restricted
Financial statements

• Operating statement
  – Revenues:
    • See AADL financial statement, p. 11
      – General Fund (definition on p.15)
        » Property Tax: $14,724,709
        » Other sources: state aid, interest income, copier revenue, fines and fees, grants and memorials
      – Other Governmental Funds (restricted)
        » Interest income: $1,987
    – Total Revenue calculated with both funds
Financial statements

• Operating statement
  – Expenditures:
    • See AADL financial statement, p. 11
      – Current
        » Personnel (41% of budget)
        » Materials and supplies (14% of budget)
      – Capital outlays/maintenance expense - $6,678,958
        » $2,812,269 in revenue not from this year – from general fund balance
      – Depreciation counted only towards net assets
      – Fund balance at beginning and end of year
        » Reduction due to capital expense
Financial statements

• Operating statement
  – See AADL statement, p. 11 – last 2 columns:
  – Adjustments
    • Personnel costs – $5,213
    • Depreciation – $705,659
    • Capital outlay – for building
  – Statement of net activities
    • Effects of year’s activities on net assets.
    • Corresponds to Management Discussion and Analysis (MD&A) statements – to be discussed
Financial statements

• Balance sheet
  – Statement of financial position/condition.
  
  – Assets = Liabilities + Net Assets

  – Assets: things of value library owns
  – Liabilities: outstanding debt
  – Net Assets (“equity” or “net worth”): portion of assets funded by library itself
  – Net Assets = Assets - Liabilities
Financial statements

• Balance sheet - Assets
  – See AADL Financial statements, p.9
  – Assets (Current)
    • Cash, investments, receivables (taxes, government transfers), prepaid expenditures (p.9)
  – Capital Assets
    • Includes: assets not being depreciated and assets being depreciated (p.9)
    • Assets not being depreciated: land, construction in progress (p.20)
    • Assets being depreciated: buildings & improvements, vehicles, equipment, furniture (p.20)
Financial statements

- **Balance sheet - Liabilities**
  - Accounts payable to vendors; accrued payroll and benefits (p.9)
  - Long-term Liabilities
    - Includes sick leave & vacation pay - $260,110 (p.21)
      - Due in 1 year: $30,000 / Due after 1 year: $230,110 (p.9)
  - Fund balances
  - Reserved for: prepaid items, encumbrances, endowment
    - Unreserved

- **Net assets:** investment in capital assets, endowments and unrestricted
Financial statements

• Net assets: 29,342,857

    equals

• Total Assets: $32,716,459

    minus

• Total Liabilities: $3,373,602
Financial statements

- Cash flow statement
  - Not reported in AADL’s audited financial statements.
Financial statements

• Components of public library audited financial statements:

  – Independent auditor’s report.
  – Management’s discussion and analysis (MD&A).
  – Basic financial statements (BFS). - reviewed
  – Notes to the financial statements.
  – Fund financial statements and schedules.
Auditor’s report

• Audit: systematic examination of an organization’s financial records to ensure accuracy of financial statements.
• NOT an opinion about financial health of an organization.
• Independent audit – conducted annually by a CPA.
• Federal government funding of >$300,000: special A-133 audit required.
  – CPA with additional training.
Auditor’s report

• What happens in an audit:
  – Examination of evidence supporting the amounts and disclosures in financial statements.
  – Assessment of internal accounting procedures.
  – Assessment of significant estimates made by management. (e.g., depreciation, bad debt)
  – Evaluation of presentation of financial statements.
Auditor’s report

- Audit opinion is found in letter at beginning: “Independent auditor’s report”.

- Answers these questions:
  - Do statements fairly report the financial position of the organization?
  - Is the organization following generally accepted accounting principles?
Auditor’s report

• Para 1: Introductory paragraph – audit work performed and responsibilities for statements.

• Para 2: Scope paragraph – description of nature of work and examples of procedures.

• Para 3: Opinion paragraph.
Auditor’s report

• Other paragraphs:
  
  – Limitations of scope of audit.
  
  – Explanation of additional components of audited statements.
Auditor’s report

• Types of audit opinions:

  – Unqualified opinion – expectations met.
    • “In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of…”
  – Qualified opinion – most expectations met.
  – Adverse opinion.
  – Disclaimer of opinion. (rarely used)
Auditor’s report

• Qualified opinion (most expectations met).

  – In two situations:
    • A single deviation from Generally Accepted Accounting Procedures (GAAP) that does not affect the remainder of financial statements.
    • Scope of limitation – parts of financial statements could not be audited – e.g., inventory of publications.
Auditor’s report

• Qualified opinion – financial statement changes.
  – Explanatory paragraph added.
  – Scope paragraph changed:
    • “Except as discussed in the following paragraph, we conducted our audit...”
  – Opinion paragraph changes.
Auditor’s report

• Qualified opinion – changes to opinion paragraph.
  – Deviation from GAAP:
    • “In our opinion, except for the effects of the library’s incorrect determination of depreciation expense, the financial statement referred to in the first paragraph presents fairly, in all material respects, the financial position of…”
  – Scope of limitations:
    • “In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to perform proper tests and procedures on the library’s inventory, the financial statement referred to in the first paragraph presents fairly….”
Auditor’s report

• Independent exercise:
  – Review the Independent Auditor’s Report for the Ann Arbor District Library.

• What types of paragraphs do you see, and what are their respective purposes?

• What type of auditor’s opinion has been provided?
  – Unqualified, Qualified, Adverse or Disclaimer?
Financial statements

• Components of public library audited financial statements:
  – Independent auditor’s report.
  – Management’s discussion and analysis (MD&A).
  – Basic financial statements (BFS).
  – Notes to the financial statements.
  – Fund financial statements and schedules.
MD&A

• Required by Governmental Accounting Standards Board.
  – See AADL statements, p. 3-8.
  – “Required supplementary information”.
  – For state and local governments (may include libraries).
  – Intended to clarify financial viability.
  – Highlights infrastructure investments.
  – Medium- to long-term focus.
MD&A

- Major content requirements:
  - Description of relationships between different financial statements – reinforce or provide new information?
  - Comparative condensed financial information.
  - Explanations of significant change in financial position and results of operations.
  - Description of capital asset and long-term debt activities in past year.
MD&A

• Government-wide financial statements:
  – Report financial position and activities without breaking down by types of funds.
  – Aggregate reporting.
  – Two types of statements:
    • Statement of net assets.
      – All of library’s assets and liabilities – difference reported as net assets.
    • Statement of activities.
      – How library’s net assets changed in most recent fiscal year.
MD&A

• Statement of net assets:
  – See AADL statement - “Total assets” (p.5)
  – “Current and other assets”: $7,335,185 (p.5)
    • Includes: cash, investments, receivables (taxes, government transfers), prepaid expenditures (p.9)
  – “Capital Assets, Net”: $25,381,274 (p.5)
    • Includes: assets not being depreciated and assets being depreciated (p.9)
    • Assets not being depreciated: land, construction in progress (p.20)
    • Assets being depreciated: buildings & improvements, vehicles, equipment, furniture (p.20)
• Statement of net assets:
  – See AADL statement - “Total liabilities” (p.5)
  – Current Liabilities outstanding: $3,113,492
    • Accounts payable to vendors; accrued payroll and benefits (p.9)
  – Other Liabilities
    • Includes sick leave & vacation pay - $260,110 (p.21)
      » Due in one year: $30,000 / Due after one year: $230,110 (p.9)
• Statement of net assets:
  – See AADL statement - “Net assets” (p.5)
    • Invested in capital assets: $25,381,274 (p.5)
      – Net of debt or long-term borrowing.
    • Restricted: $358,222 (p.5)
      – Endowments (p.9)
    • Unrestricted: $3,603,361 (p.5)
MD&A

• Libraries capital assets (net of depreciation):
  – See AADL financial statement, p.8 and p.20
    • Comparison from 2006-7 to 2007-8
    • Land – value constant (not being depreciated)
    • Buildings and construction in progress
      – +$5,948,923 (new Traverwood branch)
    • Vehicles
      – -$25,369 - depreciation
    • Equipment
      – + $36,649 (depreciation, plus new purchases – see p.20)
• Statement of activities:
  – See AADL statement, p.6
  – Net assets from 2006-2007 carried forward.
  – Total Revenue for 2007-2008: $16,264,435
    • Property Tax (91%)
    • Other sources: state aid, interest income, copier revenue, fines and fees, grants and memorials
    • Personnel, purchased services, repairs/maintenance, rent, materials and supplies, operating costs, depreciation expense
• Explanations:
  – See AADL financial statement, p.6
    • Capital outlay of $6,229,000 for new Traverwood branch

• Net assets increase: $3,158,000
Financial statements

Components of public library audited financial statements:

- Independent auditor’s report.
- Management’s discussion and analysis (MD&A).
- Basic financial statements (BFS).
- Notes to the financial statements.
- Fund financial statements and schedules.
Notes

- See AADL Financial Statements, p.14-25
  - Who is reporting.
  - What is included.
  - Policies – how items are recorded.
  - Definitions of assets, liabilities and net assets.
    - Policy regarding depreciation.
  - Types of investments.
  - Policies regarding risk of investments
Notes

• See AADL Financial Statements, p.14-25
  – Capital asset activity
  – Leases and associated commitments
  – Pension plans
Notes

• Individual exercise:

  – Review the Notes of AADL’s financial statements.
    • How long is the period of depreciation for computer equipment?
    • Where is the library authorized to invest its funds?
    • What would happen to library funds in the event of a bank failure?
    • What kind of financial commitments does the library have to its retirees?
Financial statements

- Components of public library audited financial statements:
  - Independent auditor’s report.
  - Management’s discussion and analysis (MD&A).
  - Basic financial statements (BFS).
  - Notes to the financial statements.
  - Fund financial statements and schedules.
Fund statements

• Nonmajor permanent funds (p.26-27)
  – Endowments
    • Fund balances
      – Holtrey: $328,252

• Investment income
  – Holtrey: $1,775
Fund statements

• General fund
  – A subset of general fund
Statement Analysis

• Accounting issues – accuracy of numbers on financial statements

• Financial management issues – meaning of the numbers

• Main components: ratio analysis, assessing statement of cash flows
Ratio Analysis

• Profitability
  – How large is surplus in relation to revenue?
  – Return on assets and equity
• Liquidity
  – Cash availability and use.
• Asset Management
  – Replacement of fixed assets?
• Long-term Solvency
  – How much debt relative to equity? How are current liabilities being managed?
Ratio Analysis

• Standards for comparison:
  – Industry standards
  – Historical standards
  – Managerial standards
    • Need for judgement.
Ratio Analysis

- Leverage – “Financial Risk”
  - Assets / Equity
  - If no debt – assets and equity equal = 1

- Situation 1: No debt
  - Assets: $1,000 / Liabilities: $0 / Equity: $1,000
    - Leverage = 1,000/1,000 = 1

- Situation 2: Debt of $1,000
  - Assets: $2,000 / Liabilities: $1,000 / Equity: $1,000
    - Leverage = 2,000/1,000 = 2.0
Ratio Analysis

• Leverage

  – How might you use the “leverage” to assess an organization’s financial situation?
Ratio Analysis

• Exercise:
  – How much leverage does the AADL have?
Ratio Analysis

• Exercise:

  – How much leverage does the AADL have?

  – Leverage = Assets / Equity

  – Leverage = $32,716,459 / 29,342,847 = 1.11$
Ratio Analysis

• Indicators of business risk:

  1) Small amounts of equity
  2) Few revenue sources
  3) Low administrative costs
  4) Low operating margins
Ratio Analysis

• Financial vs. business risk
  
  – Very safe: Low financial risk, low business risk
  – Danger zone: High financial risk, high business risk
  
  – If a high business risk, unwise to have a high financial risk
• How would you characterize the business and financial risk of AADL?
Ratio Analysis

• Equity:
  – Organization should finance fixed assets with a combination of long-term debt and equity.
  – A certain amount needed for replacement or upgrade of facilities, equipment, etc.
  – For nonprofits, sources of equity:
    • Contributions.
    • Operating surpluses.
  – More needed for growing organizations.
Ratio Analysis

• Equity:
  – Organization should finance fixed assets with a combination of long-term debt and equity.
  – A certain amount needed for replacement or upgrade of facilities, equipment, etc.
  – For nonprofits, sources of equity:
    • Contributions.
    • Operating surpluses.
  – More needed for growing organizations.
Ratio Analysis

• Equity:
  – Does AADL have an adequate surplus?
Ratio Analysis

- **Profitability**
  - How large is surplus in relation to revenue?
  - Return on assets and equity
- **Liquidity**
  - Cash availability and use.
- **Asset Management**
  - Replacement of fixed assets?
- **Long-term Solvency**
  - How much debt relative to equity? How are current liabilities being managed?
Ratio Analysis

- Profitability
- Liquidity
- Asset Management
- Long-term Solvency
Org. Performance

- Activity reporting: output, deliverables

- Key Performance Indicators
  - “…quantifiable measurements that will help the library define and measure progress towards its organizational goals.”
  - Intended to remain constant to permit comparisons
  - Samples
Org. Performance

• Standards

• Economic evaluation
Conclusion

• Financial statements

• Analyzing financial statements

• Organizational performance