ACCOUNTING FOR NON-ACCOUNTANTS

SPORT AND RECREATION ORGANISATIONS

—

OCTOBER 2019

SPORT NEW ZEALAND
IHI AOTEAROA

New Zealand Government

01

UNDERSTANDING FINANCIAL STATEMENTS

1.1 FINANCIAL REPORTING

As part of the governance of sport and recreation organisations, financial reports are prepared and used **to assist in the management of organisations and provide accountability and information** to their members and other stakeholders. If an organisation is a registered charity, from 1 April 2015, there is a statutory requirement to attach financial statements in a new, prescribed format with the annual return to Charities Services*. Failure to comply would likely mean losing charitable status, which means the organisation may be subject to income tax.

* If you are unsure if your organisation is a registered charity, check the charities register at www.charities.govt.nz

Amateur sports clubs are exempt from income tax, unless there is a private benefit to their members. An exemption must be applied for in writing to Inland Revenue as it does not occur automatically. In the past, charitable organisations have had no specific requirements for financial reporting.

Organisations which are not registered charities will likely have, as part of their constitution or ruling document, a requirement to produce financial reports for their members, normally on an annual basis. If the operating expenditure for an organisation is over $500,000 for the previous two accounting periods, the Charities Act requires, from 1 April 2015, that financial reports for registered charities must be audited or reviewed by a qualified auditor. A qualified auditor must be a member of an accredited body (see Financial Reporting Act sections 35 and 36).

An audit involves detailed testing of financial statements, which may include inspecting, observing, confirming, recalculating, and undertaking inquiry and analytical review, to be able to state that, in the auditor's opinion, the financial statements are free from material misstatement. The cost will vary between organisations so please contact a qualified auditor for a quote.

A review is a more limited approach and focuses on inquiry and analytical review, and concludes that nothing has been discovered that would cause a belief that the financial reports are not free from misstatement.

If a charitable organisation has expenditure of over $1 million for the last two periods, an audit must be conducted by a qualified auditor.

Organisations that are below the expenditure thresholds or are not registered as a charity may still be required to have an audit or review if the organisation's rules or constitution require one.

1.2 TYPES OF FINANCIAL STATEMENTS

STATEMENT OF FINANCIAL PERFORMANCE

This statement shows if the organisation makes a surplus or deficit from its activities conducted over a 12-month period, called the **"accounting period"**. It is titled for the year ended as it reports on 12 months of transactions. (If the reporting period is less than 12 months, the title can be changed to "the month(s) ended".)

The following elements make up the Statement of Financial Performance: Revenue, Expenses and Surplus/Deficit.

Revenue

Can be defined as income earned during the normal activities of the organisation, such as member subscriptions, donations, grants, and fundraising activities. It does not include funds received from money lent to the organisation.

Expenses

Are costs incurred to earn revenue as part of the normal activities of the organisation, such as salaries, electricity, rent, communications and printing. While most expenses are paid out of the bank account, items such as depreciation – which is the allocation of the cost of an asset, such as a computer, over its useful life – are non-cash items.

A Surplus

Will arise if revenue exceeds expenses; otherwise a deficit occurs.

STATEMENT OF FINANCIAL POSITION

The Statement of Financial Position (also referred to as "The Balance Sheet") allows readers to assess the organisation's financial standing. Three main areas make up this statement: Assets, Liabilities and Accumulated Funds. It is headed "as at" because it shows what we own and owe at a particular date.

Assets

Are what the organisation owns. Assets are broken down into categories such as current and non-current assets.

Current Assets:

Are cash or expected to be turned into cash within the next accounting period (i.e., a year). Examples are bank, member subscriptions due and inventory.

Non-Current Assets:

Are kept longer than a year, such as land, buildings and vehicles. We normally put these in a schedule at the end of the financial accounts.

Liabilities

Are obligations owed external to the organisation and are split into current and non-current liabilities.

Current Liabilities:

Are due for payment within the next accounting period and include accounts payable. They also include the current portion of long-term loans that are due for repayment in the next accounting period.

Non-Current Liabilities:

Are liabilities containing items such as mortgages and leases which are not due until the next accounting period or beyond.

Working Capital

Is the difference between current assets and current liabilities and is an important part of the Statement of Financial Position. This is because the resources to pay the current liabilities come from the current assets, once these are converted to cash.

Accumulated Funds

Are the difference between the assets and liabilities. Accumulated funds can contain funds contributed by members, accumulated surpluses, and reserves. Reserves are funds that have been set aside for a purpose such as a contingency fund in case of financial emergency, or a maintenance reserve for the organisation's buildings.

FIT TIPS

Expenditure which creates an asset is called capital expenditure.

Prudent working capital management requires that inventory and accounts receivable are turned into cash as quickly as possible to pay liabilities.

1.3 ACCRUAL AND CASH ACCOUNTING

EXAMPLE: ACCRUAL ACCOUNTING

Accrual accounting includes all transactions incurred within the accounting period, whether they have been paid in cash or not.

A tennis organisation orders a new umpire stand from Acme Engineering.

It arrives within the financial year ended 30 June 20XI, but doesn't have to be paid for until 20 July 20XI – outside the financial year.

Under accrual accounting the umpire stand must be recorded in the accounts. How?

This is done by increasing the assets and the current liabilities as an account payable.

In the same way, if a transaction is paid for within the financial period but doesn't belong there, this must be removed by reducing the expense and creating a current asset called "Prepayments".

For example, if members pay subscriptions before they are due, the subscription income is reduced and a current liability account is created called "income received in advance".

Subscriptions that are owing at the end of the year are recorded by increasing subscription income and creating a current asset called "Accounts Receivable".

EXAMPLE: CASH ACCOUNTING

Cash accounting is the simplest form of accounting and records only transactions during the accounting period which go in and out of the bank account(s). This simple example illustrates this:

A badminton organisation is owed $3,000 in subs from its members at its financial year end.

It has cash expenses of $9,000 and depreciation of $1,500. It has received cash income of $12,000.

The **difference between both methods** is $1,500 caused by the members` subs of $3,000 not yet received, less the $1,500 non-cash depreciation.

As shown in this example, there can be a difference between **accrual profit and cash surplus**. This can explain why we can make a healthy accrual profit, and yet not have as much cash in the bank as we expected.

	REVENUE	LESS EXPENSES	SURPLUS
Cash Accounting	$12,000	$9,000	$3,000
Accrual Accounting	$15,000 ($12,000 + $3,000)	$10,500 ($9,000 + $1,500)	$4,500

1.4
CASE STUDY

HAMPDEN TENNIS CLUB

Hampden Tennis Club is a fictitious New Zealand tennis club.

It is a registered charity and reports under Tier 3 of Public Benefit Entity Simple Format Reporting – Accrual (Not-for-profit).

As a prospective committee member, you have been given a preview of the financial reports section of their Performance Report, and some background information.

The club membership and subscriptions as at 30 June 20X1 are as follows (exclusive of GST):

90 adults@	$347.82
14 midweek@	$217.39
17 couples@	$521.74
178 juniors@	$310.44

During the last financial year, the club lost six adult, four midweek, and two couple memberships, but gained 15 junior members. You have been told the strong junior membership will continue, placing a strain on court use at times. Two adult members did not pay their subscriptions and their subs were written off.

Two years ago, the club undertook a strategic review.

As part of the review, the management committee was concerned about the steady decrease in adult members that had been occurring, although there had been strong growth in the juniors. It was decided to diversify the income as subscriptions were becoming unsustainable to support the club.

As the cash flow had appeared to allow it, a secretary/manager was employed at a cost of $60,000 per annum from 1 July 20X0.

SECRETARY'S MAIN FOCUS AND IDEAS

Generate income for the club, such as applying for grants for operational expenses.

Ask club members to sell wine as a fundraiser. The management committee decided to create a more social atmosphere to the club and try to raise more club funds in the process.

- A small bar area was created in the club house 18 months ago, complete with four bar tables.
- Encouraged by the initial success of the use of the bar, a part-time bar staff member was employed from 1 July 20X0 at a cost of $15,000 per annum.
- Previously club members had volunteered for bar service, with the secretary/manager holding the liquor licence.
- Project manage the new pavilion project, which has been in the planning stage for over five years. The pavilion will contain changing rooms and shower facilities, which at present do not exist.

Two years ago, a tennis coach was employed to run lessons for members and non-members. This has proved very popular, mainly due to the coach – a retired professional tennis player, now in his late 60s.

There have been some grumblings at the club about lessons taking place with ball machines and balls everywhere during the midweek.

There are eight courts in the complex, and Hampden Tennis Club was one of the first to adopt synthetic tennis courts and provide night-time lighting. The courts are now starting to show their age.

A growing source of revenue is hireage of the courts by non-members. Bookings are made online and paid by credit card, and a code is issued to unlock the security gate.

REQUIRED: Based on the information given, and from the financial reports (below), make a list of your first impressions of the club.

HAMPDEN TENNIS CLUB

Statement of Financial Performance for the year ended 30 June 20X1

	NOTES	$ 20X1	$ 20X0
REVENUE			
Grants, donations, fundraising and similar revenue	1	2,261	17,125
Fees, subscriptions and other revenue from members	2	66,435	68,474
Revenue from providing goods or services	3	125,887	83,251
Interest, dividends and other investment revenue	-	-	-
Total Revenue	**5,363**	**194,583**	**168,850**
EXPENSES			
Purchase of property, plant and equipment	4	2,087	-
Purchase of intangible assets	5	46,865	28,253
Acquisitions of investments	6	175,411	156,475
Total Expenses		**224,363**	**184,728**
Surplus/(Deficit) for the period		**(29,780)**	**(15,878)**

	NOTES	$ 20X1	$ 20X0
NOTES TO THE STATEMENT OF FINANCIAL PERFORMANCE			
Grants, donations, fundraising and similar revenue	1		
Wine sales fundraiser		2,261	-
Grants (unrestricted as to purpose)		-	17,125
Fees, subscriptions and other revenue from members	2		
Member subscriptions		66,435	68,474
Revenue from providing goods or services	3		
Bar takings		36,522	23,551
Tennis lessons		67,800	39,000
Court bookings (non-members)		21,565	20,700
		125,887	**83,251**
Fundraising expenses	4		
Wine fundraiser		2,087	-
Provision of goods or services	5		
Bar purchases		29,565	24,553
Tennis professional (lessons)		15,000	10,000
Opening bar inventory		6,300	-
Less closing inventory		4,000	6,300
Other expenses	6		
Audit		2,500	32,769
Bad debt		696	-
Bank fees		300	300
Cleaning		6,000	5,500
Depreciation		30,765	32,769
General expenses		3,561	6,779
Insurance		2,200	2,100
Interest		3,600	4,000
Electricity		24,600	22,650
Printing		1,200	800
Rates		2,300	2,150
Repairs and maintenance (tennis courts)		18,804	10,127
Repairs and maintenance (building)		2,485	5,600
Telephone/Internet		1,400	1,200
Wages and salaries		75,000	60,000
		175,411	**156,475**

HAMPDEN TENNIS CLUB

Statement of Financial Position as at 30 June 20X1

	NOTES	$ 20X1	$ 20X0
ASSETS			
Bank		27,323	12,000
Accounts receivable	7	9,100	5,800
Accrued income		-	450
Inventory		4,000	6,300
Prepayments		1,100	1,000
Total Current Assets		**41,523**	**25,550**
Non-Current Assets			
Property, plant and equipment	8	394,452	420,000
Total Assets		**435,975**	**445,550**
LIABILITIES			
Accounts payable		4,000	6,000
Accrued expenses		3,550	3,800
GST payable		6,155	3,700
Unused grant with conditions	9	30,000	-
Current portion term liabilities	10	10,000	10,000
Total Current Liabilities		**53,705**	**23,500**
Non-Current Liabilities			
Loan - Hampden Council	11	80,000	90,000
Total Liabilities		**133,705**	**113,500**
Net Assets		**302,270**	**332,050**
ACCUMULATED FUNDS			
Retained earnings		321,550	337,428
Surplus/(Deficit)		(29,780)	(15,878)
Pavilion Reserve Fund	12	10,500	10,500
		302,270	**332,050**

	NOTES	$ 20X1	$ 20X0
NOTES TO THE STATEMENT OF FINANCIAL POSITION			
Accounts receivable			
Subscriptions owing (GST inclusive)	7	9,100	5,800
Unused grant with conditions			
Pavilion fund-project not yet started	9	30,000	-
Loans			
Hampden City Council 4% interest on reduced balance	10 & 11	90,00	100,000
Pavilion Reserve Fund			
Fund for new pavilion building	12	10,500	10,500

Property, plant and equipment		8		
	Opening carrying amount	Additions	Depreciation impairment	Closing carrying amount
Club house	110,000		3,300	106,700
Land	140,000			140,000
Synthetic courts and lighting	151,000		21,895	129,105
Plant and equipment	19,000	5,217	5,570	18,647
	420,000	**5,217**	**30,765**	**394,452**

HAMPDEN TENNIS CLUB

Statement of Cash Flows as at 30 June 20X1

	NOTES	$ 20X1	$ 20X0
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash was received from:			
Donations, fundraising and other similar receipts		32,261	-
Fees, subscriptions, receipts from members		62,869	65,284
Receipts from providing goods and services		126,337	89,159
Interest, dividends and other investment receipts		-	-
Net GST		1,764	3,789
Cash was applied to:			
Payments to suppliers and employees		192,691	161,832
Total Current Assets		**30,540**	**(3,600)**
CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES			
Cash was applied to:			
Acquisition of property, plant and equipment		5,217	-
Loan repayments		10,000	10,000
Total Current Assets		**15,217**	**10,000**
Net Increase/(Decrease) in Cash		**15,323**	**25,600**
Opening Cash		**12,000**	**(13,600)**
Closing Cash		**27,323**	**12,000**
This is represented by: Bank		**27,323**	**12,000**

1.5 ANALYSIS OF FINANCIAL STATEMENTS

HAMPDEN TENNIS CLUB

Financial statements can be analysed using ratios and percentages as tools to help determine the financial health of an organisation.

The ratios may, however, in their own right not be an indicator of how truly an organisation is performing and are subject to some limitations, such as:

Historical data being used. The past may not be indicative of the future.

Changes in the way information is presented. For example expenses may be grouped differently, making comparisons difficult.

Economic environment. If the economy is poor, this will make getting grants or attracting members to your club difficult, and may not necessarily be reflective of the club.

Changing patterns and tastes. These can have an impact on financial results, for example if leisure time is scarce with busy lifestyles.

Interpreting results can be difficult. For instance, an organisation might have sold off a strategic piece of land to temporarily create more cash, improving the ratios.

Despite these limitations, ratios and percentages can be very useful in understanding financial reports.

ANALYSIS OF FINANCIAL REPORTS – HAMPDEN TENNIS CLUB

Below is a list of common ratios that have been adapted for analysis of non-profit financial reports. We will use some of these in analysing the financial performance of Hampden Tennis Club.

A) Statement of Financial Performance

* Credit sales are issued to the customer via accounts receivable; therefore cash sales are not included in the formula

RATIO	FORMULA			EXPLANATION
Gross profit margin	Gross profit / Sales	X	100 / 1	The percentage of gross profit per sales dollar from selling goods
Revenue mix	Income by category / Total income	X	100 / 1	Shows mix of income an organisation has by percentage
Mark-up	Gross profit / Cost of sales	X	100 / 1	Margin in relation to the cost of sales
Expense control	Expenses / Revenue	X	100 / 1	Individual expenses or categories of expenses can be compared as a percentage of sales. Trends are important
Fundraising efficiency	Fundraising expenses / Fundraising revenue	X	100 / 1	Measures fundraising expenses as a percentage of funds received
Programme efficiency	Programme expenses / Total expenses	X	100 / 1	Shows the amount of expenses spent on organisational programmes as opposed to total expenses
Return on revenue	Net surplus / Revenue	X	100 / 1	Surplus generated from each revenue dollar
Inventory turnover	Cost of goods sold / Average inventory	X		Efficiency of inventory management
Days of sales in inventory	Ending inventory / Cost of goods sold	X	100 / 1	An alternative method of calculating inventory sales
Average collection period	Average accts rec / Credit sales*	X	365 / 1	Average days taken in collecting accounts receivable
Return on accumulated funds	Net surplus / Avge accum funds	X	100 / 1	Shows the percentage return on accumulated funds of the organisation
Interest cover	Net surplus before int / Interest expense			Shows ability to meet interest expense from the net surplus

B) Statement of Financial Position

RATIO	FORMULA			EXPLANATION
Debt/equity	Total liabilities / Accumulated funds	X	100 / 1	Funding provided by creditors versus accumulated funds
Equity ratio	Accumulated funds / Total assets	X	100 / 1	Shows percentage of assets funded by the club
Liabilities/ assets	Total liabilities / Total assets	X	100 / 1	Percentage of assets to liabilities
Current ratio	Current assets / Current liabilities		:1	Measures ability to meet short-term debt (solvency)
Liquidity, quick or acid test ratio	Cash + accts rec / Current liabilities – bank overdraft		:1	Immediate liquidity: ability to meet immediate debts from near-cash assets
Days of cash on hand	Cash & cash equiv / Total operating exp		365	The number of days that cash is available for cash expenses
Operating reserve ratio	Operating reserves* / Total operating exp^		:1	*Operating reserves equals total unrestricted net assets minus fixed assets (net of debt) ^ Total operating expenses equals total annual expenses less depreciation

1.6 RECONCILIATION OF ACCRUAL AND OPERATING CASH SURPLUS

The net deficit in the Statement of Financial Performance for 20X1 was a loss of ($29,780) through calculating revenue and expenses under the accrual system. Net cash flow from operating activities in the cash flow statement, however, showed a surplus of $30,540.

How can we explain the difference?

We need a reconciliation that starts with the accrual loss of ($29,780) and then add back the non-cash item of depreciation and the increases and decreases in the working capital areas – which are sources of, and depletions of, cash. We should arrive at our net cash flow from operating activities of $30,540.

NET DEFICIT FROM STATEMENT OF FINANCIAL PERFORMANCE	**(29,780)**
Add back depreciation	30,765
Less decrease in accrued revenue	450
Add increase in accounts receivable	(3,300)
Less decrease in inventory	2,300
Add increase in prepayments	(100)
Add decrease in accounts payable	(2,000)
Add decrease in accrued expenses	(250)
Less increase in GST	2,455
Less increase in unused grant with conditions	30,000
Net cash flow from operating activities	**30,450**

The accrual loss of ($29,780) is reconciled to the cash increase from operating activities of $30,540.

Cash flow statements are useful to see the differences between the accrual surplus or deficit and the net cash flow operating activities increase or decrease. Although there has been an accrual loss, there has been a cash increase from operating activities.

The two main causes of these differences are the non-cash expense of depreciation and the unused grant.

1.7 ANALYSIS OF STATEMENT OF FINANCIAL PERFORMANCE

FINANCIAL PERFORMANCE

Revenue – Vertical analysis

The vertical analysis shows the percentage of a line item, such as member subscriptions, against total revenue. It is calculated as follows:

$$\frac{\text{Revenue item}}{\text{Total revenue}} \times \frac{100}{1}$$

Example for wine sales fundraiser

$$\frac{2{,}261}{194{,}583} \times \frac{100}{1} = 1\%$$

REVENUE ITEM	$ 20X1	% OF REVENUE	$ 20X0	% OF REVENUE
Wine sales fundraiser	2,261	1%*	-	0%
Grants	-	0%	17,125	10%
Member subscriptions	66,435	34%	68,474	41%
Bar takings	36,522	19%	23,551	14%
Tennis lessons	67,800	35%	39,000	23%
Court bookings	21,565	11%	20,700	12%
Total Revenue	**194,583**	**100%**	**168,850**	**100%**

Horizontal analysis

The horizontal analysis shows the percentage increase or decrease of a revenue item between a base year and one or more years. It is calculated as follows:

Dollar change = amount of item in comparison year (20X1) – amount in base year (20X0)

$$\frac{\text{Dollar change}}{\text{Amount of item in base year}} \times \frac{100}{1}$$

Example for member subscriptions:

$$\frac{66{,}435 - 68{,}474}{68{,}474} \times \frac{100}{1} = -3\%$$

The vertical analysis shows membership revenue declining from 41% to 34% as a total of revenue, but down only 3% between the years, as shown by the horizontal analysis.

Tennis lessons have increased dramatically as a percentage of total revenue from 23% in 20X0 to 35% in 20X1 from the vertical analysis. The horizontal analysis shows a 73.8% increase between 20X0 and 20X1. Bar takings have also increased dramatically, but this is due to a full trading year in 20X1.

REVENUE ITEM	$ 20X1	$ 20X0	% 20X0/20X1
Wine sales fundraiser	2,261	-	-
Grants	-	17,125	-
Member subscriptions	66,435	68,474	-3%
Bar takings	36,522	23,551	55%
Tennis lessons	67,800	39,000	73.8%
Court bookings	21,565	20,700	4.1%
Total Revenue	**194,583**	**168,850**	**15.2%**

Grants, donations and fundraising

A major focus of the new manager was to raise revenue to diversify from its subscription base. An initiative was to purchase wine from a local winery and ask members to sell this. As at 30 June 20X1 all the wine had been sold.

Fundraising efficiency	$\frac{\text{Fundraising expenses}}{\text{Fundraising revenue}}$	X	$\frac{100}{1}$	
20X1	$\frac{2,087}{2,261}$	X	$\frac{100}{1}$	92.3% of revenue is taken up with expenses
Gross profit margin	$\frac{\text{Gross profit}}{\text{Sales}}$	X	$\frac{100}{1}$	
20X1	$\frac{174*}{2,261}$	X	$\frac{100}{1}$	7.7% – this means 7.7 cents gross profit per $1 of sales

*Gross profit calculation: Wine sales $2,261 less cost of wine $2,087 = $174

The profit was probably not worth the effort, and questions should be raised about the selling price per bottle, which has led to a small profit.

During the year a grant of $30,000 was received to assist with the building programme of the new pavilion. This grant cannot be included as revenue until it is used for the purpose for which it was given, which is building the pavilion, not yet begun. No other grant money was received during the year, despite this being a focus of the new manager.

From the vertical analysis, we have seen that the revenue is split amongst five areas, with subscriptions from members contributing 34% of the revenue. This has meant attempting to diversify its income to meet the costs of running the club. The membership has been falling, and also two bad debts occurred during the year – which apparently has never occurred before (assume a beginning debtors figure for 20X0 of $2,700).

Average collection period subscriptions	$\frac{\text{Average accts rec}}{\text{Credit sales}}$	X	$\frac{365}{1}$	
20X1	$\frac{9,100 + 5,800)/2}{66,435}$	X	$\frac{365}{1}$	41 days
20X0	$\frac{(5,800 + 2,700)/2}{68,474}$	X	$\frac{365}{1}$	22 days

As can be seen, the average time to collect subscriptions in 20X0 was 22 days, and increasing to 41 days – a worrying trend, especially as there are falling club member numbers in the higher subscription category. The influx of juniors is bringing in more revenue but is the cause of complaints from the adult members because of their large usage of court time.

REVENUE FROM PROVIDING GOODS OR SERVICES:

Bar Takings

The mark-up and gross profit percentages have considerably weakened from 20X0 to 20X1. This requires investigation into why this has occurred.

The question also might be asked, after a modest profit in 20X0, why the club decided to spend $15,000 in wages in 20X1 on a part-time bar person.

The inventory turnover has improved – that is, the club is selling more, but both mark-up and gross profit percentages offset the higher volume of sales.

It should also be pointed out that other expenses, such as electricity, have not been allocated to the bar, which would make the situation even more unprofitable.

		$ 20X1		$ 20X0
Bar sales		36,522		23,551
Less:				
Cost of sales				
Opening inventory	6,300		-	
Add purchases	29,565		24,553	
Less closing inventory	4,000	31,865	6,300	18,253
Gross profit		**4,657**		**5,298**
Less closing inventory		15,000		0
Net/(loss) profit		**(10,343)**		5,298

Gross profit mark-up	$\frac{\text{Gross profit}}{\text{Cost of sales}}$	X	$\frac{100}{1}$	
20X1	$\frac{4,657}{31,865}$	X	$\frac{365}{1}$	= 14.7%
20X0	$\frac{5,298}{18,253}$	X	$\frac{100}{1}$	= 29.0%
Gross profit margin	$\frac{\text{Gross profit}}{\text{Sales}}$	X	$\frac{100}{1}$	
20X1	$\frac{4,657}{36,522}$	X	$\frac{365}{1}$	= 12.7%
20X0	$\frac{5,298}{23,551}$	X	$\frac{100}{1}$	= 22.5%
Inventory turnover	$\frac{\text{Cost of goods sold}}{\text{Average inventory}}$			
20X1	$\frac{31,865}{(6,300 + 4,000)/2}$			= 6.2 times
20X0	$\frac{18,253}{(6,300 + 0)/2}$			= 5.8 times

Tennis Lessons

These began in 20X0 when the club received an approach from retired tennis professional Lewis Christian. They have proved to be very popular, especially amongst the high schools, which are sending students for lessons. The lessons are held in groups of 10, at a cost of $30 + gst per person.

In 20X0, 127 hours of lessons were held for $39,000 in sales, the cost of which was $10,000 paid to Lewis. This yielded a profit of $29,000.

There are no significant additional costs as Lewis is able to use old club tennis balls, and while they are not new, they are acceptable to use.

Realising how much profit the club was making from him, Lewis demanded an increase in his fee to the club for the next season.

During 20X1 the 226 hours of lessons were fully booked out and made a profit of $52,800. Some members have heard rumblings from Lewis that the hourly fee of just over $66 he receives is still not enough.

The sales for 20X1 are calculated as 226 hours of lessons with 10 people paying $30 each – therefore 226 x 10 people x $30 = $67,800 less the $15,000 dollars paid to the professional.

Gross profit margin	$\frac{\text{Gross profit}}{\text{Sales}}$	X	$\frac{100}{1}$	
20X1	$\frac{52,800}{67,800}$	X	$\frac{365}{1}$	= 78%
20X0	$\frac{29,000}{39,000}$	X	$\frac{100}{1}$	= 74%

The profits, with no other significant expenses, are good at 74 cents per every dollar in 20X0 and increasing to 78 cents in 20X1.

There is a risk to this income, however, as the professional is rumoured to be unhappy with his fees, and his coaching abilities make him an attractive drawcard for the club.

Court Bookings

Non-members

Non-members can book courts online and receive a code to unlock the club gate. The manager keeps an eye on the bookings during the week days to ensure their stay is no longer than booked.

Bookings from 5pm to 9pm on week nights are not policed, apart from any club members who may question non-members on courts.

The cost to book a court is $46 + gst per hour.

Some of the more social members of the club who don't enter the competitions believe this is too cheap, and if four people play the cost is only $11.50 + gst each. They are thinking of resigning and just paying the casual rates.

In 20X0, 450 hours were booked, and in 20X1, 469 hours. This averages out to around 25 hours per week over the season's 18 weeks. Most of the play occurs during the week days and on Sundays, with not too much distraction to the normal membership.

The income of $20,700 in 20X0 and $21,565 in 20X1 has no direct expenses, except the wear and tear on the synthetic courts.

Expenses

Vertical analysis

The vertical analysis for expenses is expressed as a percentage of total expenses.

EXPENSE ITEM	$ 20X1	% OF EXPENSES	$ 20X0	% OF REVENUE
Audit	2,500	1.3	2,500	1.5
Bad debt	696	0.4	-	-
Bank fees	300	0.2	300	0.2
Cleaning	6,000	3.1	5,500	3.3
Depreciation	30,765	15.8	32,769	19.4
General expenses	3,561	1.8	6,779	4.0
Insurance	2,200	1.1	2,100	1.2
Interest	3,600	1.9	4,000	2.4
Electricity	24,600	12.6	22,650	13.4
Printing	1,200	0.6	800	0.5
Rates	2,300	1.2	2,150	1.3
Repairs & maintenance (courts)	18,804	9.7	10,127	6.0
Repairs & maintenance (building)	2,485	1.3	5,600	3.3
Telephone/Internet	1,400	0.7	1,200	0.7
Wages & salary	75,000	38.5	60,000	35.6
Revenue	**194,583**		**168,850**	

Horizontal analysis

The horizontal analysis shows the percentage increase in expenses from 20X0 (base year) to 20XI.

EXPENSE ITEM	$ 20XI	$ 20X0	% CHANGE
Audit	2,500	2,500	-
Bad debt	696	-	-
Bank fees	300	300	-
Cleaning	6,000	5,500	9
Depreciation	30,765	32,769	(6)
General expenses	3,561	6,779	(48)
Insurance	2,200	2,100	5
Interest	3,600	4,000	(10)
Electricity	24,600	22,650	8
Printing	1,200	800	50
Rates	2,300	2,150	7
Repairs & maintenance (courts)	18,804	10,127	86
Repairs & maintenance (building)	2,485	5,600	(56)
Telephone/Internet	1,400	1,200	17
Wages & salary	75,000	60,000	25

Repairs and maintenance of courts is a concern and shows an 86% increase from 20X0 to 20XI in the horizontal analysis.

Wages and salary has increased due to the employment of a part-time bar staff member.

In analysing the vertical and horizontal expenses, attention should be paid to the percentage increases, although some items might display a large percentage increase, but a relatively small dollar amount.

We need to determine why there are significant changes, and whether– such as in the case of repairs and maintenance for the tennis courts - this trend is going to continue.

1.8 ANALYSIS OF STATEMENT OF FINANCIAL POSITION

WORKING CAPITAL

Working capital is the difference between the current assets and current liabilities.

In 20X0 there is $25,550 of current assets less $23,500 of current liabilities. This means there is an excess of current assets of $2,050 ($25,550 – $23,500).

For the 20X1 year, current liabilities exceed current assets by $12,182.

Further analysis of the working capital for 20X1 presents a problem.

The operating bank account as at 30 June 20X1 contains $27,323, which is less than the grant of $30,000. No separate bank account has been set up to tag these funds, which means the funds have been combined with the operating bank account. The grant received has been used to pay operating expenses and other costs, which is a serious financial position to be in.

We can further analyse working capital as follows:

Current Ratio

This ratio assesses our ability to pay our current liabilities from our current assets.

Current ratio	$\frac{\text{Current assets}}{\text{Current liabilities}}$	:1	Ideal ratio is 2:1 ($2 of current assets to $1 of current liabilities)
20X1	$\frac{41,523}{53,705}$	= 0.77:1	This means there is 77 cents of current assets for every current liability
20X0	$\frac{25,550}{23,500}$	= 1.08:1	This means there is 1.08 cents of current assets for every current liability

Quick Asset Ratio

Inventory is removed from the calculation as, in a situation where cash is needed in a hurry, selling inventory would likely lead to reduced selling prices, which might damage the business even further.

Quick asset ratio	$\frac{\text{Cash + accts rec – inventory}}{\text{Current liabilities}}$	:1	The ratio assesses the entity's ability to pay its current liabilities with inventory removed. Ideal ratio is 1:1 ($1 of current assets to $1 of current liabilities)
20X1	$\frac{37,523}{53,705}$	= 0. 70:1	This means there is 70 cents of current assets for every current liability dollar
20X0	$\frac{19,250}{23,500}$	= 0.82:1	This means there is 82 cents of current assets for every current liability dollar

Debt to Equity

This shows the funding provided by creditors versus accumulated funds. An organisation should, as a general rule, own more of itself than its creditors do.

Debt to equity ratio	Total liabilities / Accumulated funds	:1	Ideal is to have more equity than debt
20X1	133,705 / 302,270	= 0.44:1	This means there is 44 cents of liabilities to an accumulated funds dollar
20X0	113,500 / 332,050	= 0.34:1	This means there is 34 cents of liabilities to an accumulated funds dollar

While the ratio is less than 50 cents of total liabilities to accumulated funds, the trend is unfavourable and upwards from 0.34 to 0.44

Liabilities to Assets

This measures the percentage of assets funded by liabilities.

Liabilities to assets	Total liabilities / Total assets	X	100 / 1		Ideal ratio is <50%
20X1	133,705 / 435,975	X	100 / 1	= 30.7%	This means assets are 30.7% funded by liabilities
20X0	113,500 / 445,550	X	100 / 1	= 25.5%	This means assets are 25.5% funded by liabilities

While the organisation's assets are funded less than 50% liabilities, a concern is the increase from 20X0 to 20X1.

Equity Ratio

This is the inverse of the total liabilities to total assets percentage and shows the percentage of assets funded by the club.

Equity ratio	Accumulated funds / Total assets	X	100 / 1		Ideal ratio is >50% equity or ownership of assets
20X1	302,270 / 435,975	X	100 / 1	= 69.3%	This means the organisation owns 69.3% of its assets
20X0	332,050 / 445,550	X	100 / 1	= 74.5%	This means the organisation owns 74.5% of its assets

From 20X0 to 20X1 the percentage has worsened, with the club now owning 5.2% less of its assets.

Unrestricted Net Assets Ratio

Due to the uncertain nature of non-profit organisations (unanticipated decrease in revenues or increases in expenses), reserves are sometimes held to cushion the impact. Hampden Tennis Club has no reserves set aside in a bank account for this purpose. It does have a Pavilion Reserve Fund of $10,500 for the building – but these funds are not held in a separate bank account.

If an organisation is creating a reserve out of its own funds, best practice is to ring-fence them by opening a separate bank account. That way the money does not get mixed up with the normal operating bank account.

During 20X1 Hampden Tennis Club received a grant of $30,000 towards the new pavilion. This is restricted to being used for pavilion funds only. This remains a liability until it is spent on its restricted purpose, at which point it transfers from being a liability to income. However, similar to the club's own pavilion fund, the $30,000 has been included in the normal bank account and, as noted above under working capital, this is undesirable to say the least.

The unrestricted net assets ratio measures are the amount of net assets not subject to restrictions as a percentage of operating expenses.

Unrestricted net assets ratio	$\frac{\text{Unrestricted net assets}}{\text{Total operating expenses}}$	X	$\frac{100}{1}$	Ideal is >100%		
20X1	$\frac{262{,}475^{*}}{224{,}263}$	X	$\frac{100}{1}$	= 117%	*Net assets less pavilion fund less restricted grant ($302,975 – $10,500 – $30,000 = $262,475)	
20X0	$\frac{321{,}550^{\wedge}}{184{,}728}$	X	$\frac{100}{1}$	= 174%	^Net assets less pavilion fund less restricted grant ($332,050 – $10,500 – $) = $321,550	

The unrestricted net assets to operating expenses in 20X0 is good at 174% of expenses, i.e., the net assets of the organisation cover well over a year's worth of expenses. However, in 20X1 this worsens to 117%.

Days of Cash on Hand

This measures the number of days of cash that an organisation has to pay its current obligations.

Days of cash on hand	Cash & cash equiv* / Total operating exp – depn		
		X 365	Ideal ratio is at least 90 days
20X1	27,323 / 224,363 – 30,765	X 365	= 51 days
20X0	12,000 / 184,728 – 32,769	X 365	= 29 days

*Cash and cash equivalents include term deposits (if any)

While this ratio looks healthy and increases dramatically from 20X0 to 20X1 – the bank account figure contains restricted cash – i.e., $10,500 for the pavilion reserve in both 20X0 and 20X1 – and in 20X1 there is a $30,000 restricted grant that has been deposited.

If we remove the restricted reserve ($10,500) and cash grant item ($30,000), the days of cash on hand looks like this:

20X1	27,323 – 10,500 – 30,000 / 224,363 – 30,765	X 365	= -24.8 days
20X0	12,000 – 10,500 / 184,728 – 32,769	X 365	= 3.6 days

The days of cash on hand now moves from 3.6 days to negative -24.8 days, which of course is a very serious situation and means it is unable to pay its obligations.

1.9 EXERCISE 1

FINANCIAL ACCOUNTS ANALYSIS

The Tuki Tuki Greens Golf Club Inc. is a non-profit golf club, which has had ups and downs financially in recent years.

The club has 194 members in 20X2 – up from 190 in 20X1. Due to the very low membership numbers, which are capped at 200, club members occasionally contribute financially to the club. They are quite happy to do that, as no bookings are required to play the course because of the low membership numbers for a golf course of this quality.

From the start, the club has leased the golf course from a nearby farming family trust, but owns all of the improvements such as the club house and maintenance equipment sheds.

To save cash handling and bank fees, club members must use their club membership cards to purchase items from the bar, which means all sales are on credit and are entered through the club's computer system. At the end of the month members are emailed a statement and expected to settle in full within 20 days.

A committee member of the golf club's management team has approached you for help to analyse the accounts as he is concerned about the club's financial position, especially as he may get some tricky questions at the annual general meeting coming up.

Additional information

- The club levied members an extra $110,000 during the year to pay for fairway irrigation and replacement fixed assets.
- The level of both Inventory and Accounts Receivable remained stable throughout 20X1, so the closing balance figures at year end can be used as an average.
- The loan, which was taken out on 1 October 20X1, is an interest-only loan, and repayable in five years' time. Interest is payable at 8% per annum.
- The interest rate payable on the mortgage is 10% per year and the mortgage was increased on 1 October 20X1.
- The club is very unhappy with the financial position for 20X2, given the successful efforts to increase bar sales and to raise the capital from members.

TUKI TUKI GREENS GOLF CLUB INCORPORATED

Statement of Financial Performance for the year ended 30 September 20X2

		$ 20X2		$ 20X1
Member subscriptions (all credit)		290,000		285,000
Sales (all credit)	330,000		230,000	
Less cost of sales	180,000		140,000	
Gross Profit		150,000		90,000
Rent Received		10,000		10,000
Total Revenue		**450,000**		**385,000**
Less operating expenses				
Course maintenance	326,000		277,000	
Administration	80,000		70,000	
Financial	24,000	430,000	18,000	365,000
Surplus		**20,000**		**20,000**

TUKI TUKI GREENS GOLF CLUB INCORPORATED

Statement of Financial Performance for the year ended 30 September 20X2

	$ 20X1	$ 20X0
Accumulated Funds		
Capital from members	70,000	50,000
Reserves	110,000	
Surplus	20,000	20,000
Total	**200,000**	**70,000**
Represented by		
Course maintenance		
Cash	2,000	-
Prepaid expenses	8,000	-
Subscriptions due	40,000	25,000
Accounts receivable (bar sales)	60,000	25,000
Inventory (bar stock)	90,000	30,000
Total	**200,000**	**80,000**
Non-Current Assets		
Buildings	110,000	116,000
Course improvements	126,000	24,000
Machinery	64,000	50,000
Total	**300,000**	**190,000**
Total Assets	**500,000**	**270,000**
Current Liabilities		
Bank overdraft	35,000	80,000
Accounts payable	63,000	45,000
GST payable	22,000	15,000
Total	**120,000**	**140,000**
Non-Current Liabilities		
Loan	60,000	
Mortgage	120,000	60,000
Total	**180,000**	**60,000**
Total Liabilities	**300,000**	**200,000**
Net Assets	**200,000**	**70,000**

REQUIRED:

A. Using the ratio formulas provided above on pages 20 and 21, analyse the accounts using the following:

- Gross profit margin
- Mark-up
- Net profit margin
- Inventory turnover
- Average collection period – bar sales
- Average collection period – subscriptions due
- Working capital
- Current ratio
- Liquidity ratio
- Quick assets ratio
- Expense control for course maintenance
- Administration and financial
- Interest cover
- Equity ratio
- Liabilities to assets.

B. Interpret the results

C. Make any recommendations

* Suggested solutions are in Chapter 5.0

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SPNZ 00037
November 2019