Fair Work Commission

Guide to Understanding Financial Statements

MD 003 | Updated: 17 March 2023

Fair Work Commission

Contents

Background 3

The Importance of Financial Management 4

Accountability and financial governance 4

Financial Management in Not for Profit Organisations 6

The Key Financial Statements 7

Statement of Comprehensive Income 8

Statement of Financial Position 9

Assets 9

Liabilities 10

Equity 10

Statement of Changes in Equity 11

Statement of Cash Flows 11

Notes to and Forming Part of the Financial Statements 12

Independent Audit Report 13

Analysis of Financial Statements 13

Financial ratios 14

Other Indicators 16

Summary 16

Fair Work Commission

Background

As a member of a Registered Organisation (organisation) you are entitled to receive certain reports relating to the financial position and financial performance of the organisation. Your organisation must provide you (free of charge) with what the *Fair Work (Registered Organisations) Act 2009* (RO Act) calls a 'full report', an operating report and an officer and related party disclosure statement. The 'full report' consists of a:

- Statement of Comprehensive Income (also known as a Profit and Loss Statement);
- Statement of Financial Position (also known as a Balance Sheet);
- Statement of Cash Flows;
- Statement of Changes in Equity;
- Notes to the Financial Statement;
- Subsection 255(2A) Report;
- Officer's Declaration Statement (if applicable);
- Committee of Management Statement; and
- Auditor's Report

This guide will explore and unpack some of these documents and provide an overview of their purpose as well as some of the accounting concepts behind their preparation. It is our intention that this guide is used as a resource to assist you in reading and understanding the key financial statements. This guide will provide you with a range of tools to assist you to analyse your organisation's financial performance and financial position.

For further information on the financial reporting obligations under the RO Act and the role of the Fair Work Commission (the Commission) please refer to the following link: financial reporting

Fair Work Commission

The Importance of Financial Management

Financial management is about dealing with financial information to ensure the most effective use of financial resources. As a member you need to be confident that your organisation adopts and follows sound financial management practices to ensure its financial resources are being managed effectively and efficiently.

Reading financial statements, such as those of your registered organisation, can be a complex exercise. Understanding the language of finance can be daunting. Accounting terms can be confusing and some of the items commonly shown in financial statements may be unfamiliar. Explanations of some of these terms can be found in our fact sheets linked below:

Glossary of Accounting Terms

Fair Work Commission Key Financial Terms

Accountability and financial governance

Key intentions of the RO Act are to:

- Ensure that employer and employee organisations registered under the RO Act are representative of, and accountable to, their members and are able to operate effectively;
- Encourage members to participate in the affairs of the organisations to which they belong; and
- Encourage the efficient management of organisations and high standards of accountability of organisations to their members.

Office holders are expected to act with integrity at all times and to behave ethically when dealing with the organisation's finances. Sound financial management and reporting must be supported by processes that ensure the information in financial statements provides a true and fair view of the entity's financial performance and position.

The RO Act sets out the requirements that are placed on organisations in relation to financial records, accounting and auditing. The RO Act also requires that the rules of the organisation must provide for, amongst other things:

- The manner in which the property of the organisation is to be controlled and its funds invested;
- The yearly or more frequent audit of the accounts; and

Fair Work Commission

- The conditions under which funds may be spent.

The RO Act also sets out the general duties of officers and employees in relation to the financial management of an organisation. Those duties are referred to in our Officers Induction Kit which can be accessed via the following link: Officer Induction Kit.

For more information about the financial management obligations under the RO Act and the records to be kept by registered organisations, please refer to the following link: Records to be kept by registered organisations.

Fair Work Commission

Financial Management in Not for Profit Organisations

Registered organisations operate within the general definition of “not-for-profit” entities. Yet your organisation’s financials will show a profit or a loss (sometimes shown as a surplus or deficit). So, can a so-called not-for-profit organisation make a profit? The answer is yes and the explanation lies in what the term “not-for-profit” means. Not-for-profit does not mean “for loss”. Generally, organisations must operate profitably if they are to be financially sustainable.

The distinction is that for-profit organisations generate profits to create wealth for individuals through the issue of shares and the distribution of dividends. Not-for-profit organisations, on the other hand, do not have the power to distribute income or assets to their members. While generating profits is not only permissible, but essential for sustainability of the organisation, they reinvest those profits to accomplish their mission and purpose.

Note: The fundamentals of financial management, governance and accountability apply equally to for-profit and not-for-profit organisations.

The level of profit generated by your organisation is significant to you as a member. The financial health of your organisation is an indication of its sustainability. You want your organisation to be ongoing so that it can continue to provide you with the benefits of membership. To achieve this, it needs to be able to acquire and replace assets, such as property, plant, equipment, etc. It also needs to be able to invest in future opportunities, such as embracing new technology or expanding its offerings to members. Generating profits allows these activities to be funded.

So how much profit is enough? There is no definitive answer, as there is no limit to the amount of profits that may be generated. Accountability to members lies in the application of those profits. Since 100% of profits are reinvested then, as a member, your concern is that profits are being put to good use, to maintain and improve conditions for members, to give you what you pay for.

The Key Financial Statements

The RO Act requires that the financial statements of an organisation must be prepared in accordance with Australian Accounting Standards, the RO Act, the *Fair Work (Registered Organisations) Regulations 2009* and the Commission's reporting guidelines.

For further information on the Commission's reporting guidelines, please refer to the following link: Tools and templates.

In accordance with the above requirements and guidelines, your organisation's annual financial report includes a number of key financial statements and supporting documents.

Key Financial Statements

- Statement of Comprehensive Income
- Statement of Financial Position
- Statement of Changes in Equity
- Statement of Cash Flows

Supporting Documents

- Notes to and forming part of the financial statements
- Independent Audit Report

In preparing the financial statements, the organisation must comply with a number of accounting concepts and principles. These aim to ensure accuracy, reliability and consistency in financial statements. One accounting concept that is central to the preparation of the Statement of Comprehensive Income is “accrual accounting”, which recognises revenue and expenses when a transaction takes place.

Accrual Accounting

- **Revenue** is recognised when it is earned
- **Expenses** are recognised when they are incurred

This differs from “cash accounting”, which recognises revenue and expenses when cash is received or a payment is made.

For more information on accrual accounting and other concepts and principles, please refer to the following fact sheet:

Common Accounting Concepts and Principles

Statement of Comprehensive Income

Sometimes referred to as the Profit and Loss Statement, it reports the organisation’s financial performance over an identified reporting period, known as the organisation’s financial year. Expenses incurred during a nominated period are subtracted from the revenue earned during the same period to determine the profit or loss generated in the period. This represents the operating result, or the “bottom line”.

This statement also provides details of “other comprehensive income”. This includes items such as gains or losses on investments, revaluation of land and buildings and other items outside the organisation’s core business activities. For an example of a Statement of Comprehensive Income, please refer to the following fact sheet:

Sample Financial Statements

Statement of Financial Position

This statement, otherwise known as the Balance Sheet, shows what the organisation controls (assets) and what it owes (liabilities) at the end of the reporting period. The difference between assets and liabilities is called equity and represents the net worth of the organisation.

Assets

Assets describe the items of value that the organisation controls, or has a right to. They include cash, receivables, land and buildings, equipment, vehicles, computers, etc. They also include intangibles (those assets that are not physical in nature), such as intellectual property and software. Assets are further categorised under the sub-headings Current Assets and Non-Current Assets.

Current assets are those that are expected to be converted into cash, or consumed, within 12 months. Examples include cash, trade and other receivables and prepayments

Non-current assets are those that are used in the business and help to generate income beyond 12 months. Examples include land and buildings, plant and equipment, motor vehicles and computers

Liabilities

Liabilities are amounts owed by the organisation to external parties. They are financial obligations of the organisation to another party or organisation. Examples include amounts owed to suppliers (accounts payable) and financiers (loans), as well as various staff entitlements, including annual leave and long service leave. Liabilities are further classified under the sub-headings Current Liabilities and Non-Current Liabilities.

Current liabilities are short-term commitments i.e. debts due to be paid within the next 12 months. Examples include accounts payable, bank overdraft, short-term-loans and provision for employees' annual leave entitlements

Non-current liabilities are longer-term commitments i.e. debts not due within the next 12 months. Examples include mortgages and other long-term commitments, including employees' long service leave commitments

Equity

Equity is an accounting term that is synonymous with the organisation's net worth.

Example: Your organisation purchases a building for $10 million, financed partly by a mortgage of $8 million. This would mean the equity in the building is $2 million.

While the organisation controls the asset, the organisation would effectively "own" 20% of that building. The building would be shown in the statement of financial position as a non-current asset ($10M) and the loan would be shown as a non-current liability ($8M). The difference would form part of the total equity or net worth of the organisation.

Equity mainly consists of accumulated surpluses/deficits and general funds, such as reserves.

For an example of a Statement of Financial Position, please refer to the following fact sheet:

Sample Financial Statements

Statement of Changes in Equity

This statement provides details of the change in equity during the reporting period. For example, when an organisation reports a profit or a loss, the effect is to increase or decrease equity by that amount. Similarly, any increases or decreases in general funds are reflected in the statement of changes in equity.

For an example of a Statement of Changes in Equity, please refer to the following fact sheet:

Sample Financial Statements

Statement of Cash Flows

This statement reports the inflows and outflows of cash over the reporting period. It shows the flow of funds into and out of the organisation. The difference between receipts and payments is the net movement in cash for the period.

In some ways the cash flow statement looks similar to the profit and loss statement, however there are major differences. These are mostly timing differences and they are fundamental to financial performance which is reported according to the accrual accounting method.

Cash inflows and outflows occur as a result of three major types of activities.

Operating Activities

When members pay subscriptions, when rental or interest on deposits are received, cash flows into the organisation. Conversely, when payments are made to suppliers or to staff, cash flows out of the organisation

Investing Activities

When an organisation acquires non-current assets (e.g. furniture, computers), cash flows out of the organisation. If non-current assets are disposed of, (for a price) cash flows into the organisation

Financing Activities

Cash inflows occur whenever an organisation raises capital via borrowings or from other external parties, such as non-controlling entities. Cash outflows occur when the organisation makes repayments to these parties

Note: Inflows and outflows of cash occur on a regular basis. Operating activities may take place many times a day, while investing and financing activities occur less often.

For an example of a Statement of Cash Flows, please refer to the following fact sheet:

Sample Financial Statements

Notes to and Forming Part of the Financial Statements

The key financial statements contain vital information, however they provide only a snapshot of the organisation's financial performance and position. If you want to explore further, analyse results or undertake

Fair Work Commission

comparisons with other organisations, you need to look beyond the raw numbers. The notes to the financial statements provide detail and explanations of these numbers.

In some cases, accounting standards may allow a choice regarding the accounting treatment to be adopted. Where a choice exists, the method chosen by the organisation becomes an accounting policy and must be applied consistently. Accounting policies must be disclosed in the notes to the financial statements and are shown as: “Note 1. Summary of significant accounting policies”.

For an example of Notes to the Financial Statements, please refer to the model financial statements on the Commission website in Tools and Templates.

Independent Audit Report

The RO Act requires all registered organisations to have their annual financial reports audited by an auditor registered with the Commission. The function of the auditor is to report whether the financial statements, including the accompanying notes, present a true and fair view of its financial performance, position and cash flows and are prepared in accordance with Australian Accounting Standards and any other requirements imposed by the RO Act and the Commission’s Reporting Guidelines. The aim of the audit report is to give members assurance that the information is correct and free from material misstatements.

Note: The audit report offers no opinion as to the adequacy, or otherwise, of the organisation’s financial performance and position. Those considerations are for the members and other stakeholders to determine, based on analysis of the financial statements

Analysis of Financial Statements

As a member, you want to be sure your organisation is being well managed and delivering its objectives in a financially effective and efficient manner. By examining the organisation’s financial statements you can gain an insight into its current financial performance and position, understand its strengths and weaknesses, identify risk areas and predict its likely future performance, viability and sustainability.

A cursory look at each of the financial statements provides some broad information about your organisation’s financial health.

Fair Work
Commission

Statement of Comprehensive Income	Statement of Financial Position	Statement of Cash Flows
Reveals whether the organisation is making a profit or a loss	Shows whether the organisation has positive or negative equity	Indicates whether the cash held is increasing or decreasing

These are fundamental observations, however closer examination and further analysis of the numbers are required in order to gain an understanding as to whether financial performance and position are satisfactory. For example, a profit may have been generated, but was it enough? How much is enough? A positive cash position may be revealed, but is there sufficient cash to sustain operations going forward?

Financial ratios

A common method for analysing financial performance that can assist you to explore further these initial observations is called ratio analysis. Below are some examples of commonly used financial ratios that could be useful for analysing the financial statements of your organisation.

Fair Work Commission

Net Profit Margin	$\frac{\text{Net Profit}}{\text{Total Revenue}} \times 100$	When comparing organisations, the extent to which they are similar, as well as the accounting policies adopted by them, will determine the validity of such comparisons.
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	Indicates the organisation's liquidity, i.e. its ability to meet short-term obligations. Current assets should exceed current liabilities
Equity Ratio	$\frac{\text{Total Equity}}{\text{Total Assets}} \times 100$	Provides a measure of solvency by showing the extent to which the organisation's assets are funded internally, compared with external parties such as banks, suppliers, etc.

Members should also compare these ratios with previous years to look for any trends or patterns. For example, an increase year on year in the overall profit would be a positive trend, whereas a decreasing profit could indicate a potential risk.

It may also be useful to benchmark your organisation's performance by comparing the financial ratios with other organisations.

Note: When comparing organisations, the extent to which they are similar, as well as the accounting policies adopted by them, will determine the validity of such comparisons.

For some further examples of financial ratios and calculations, please refer to the following fact sheet: [Financial Ratios]

Fair Work Commission

Other Indicators

As a general guideline, you should investigate anything that you find surprising, or that you don't understand, in your organisation's financial statements. These might relate to issues such as:

- A significant decrease in revenue compared with previous years
- A significant increase in expenses in comparison with previous years
- The appearance of an unusual expense
- A change in the amount of debt or other liabilities
- Any item classified as "other", without any explanation in the notes to the financial statements.

Summary

As discussed earlier, as a member of your organisation, you are entitled to receive its annual financial report, consider the contents of the financial statements and make any necessary enquiries, including seeking clarification. This includes your right to attend the annual general meeting and direct questions directly to those responsible for managing the organisation.