# How to Read and Interpret Financial Statements

BASICS OF NON-PROFIT FINANCE SERIES
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# Accounting is a Language

# Statement of Operations covers a Period of Time



- Revenues – recorded when services are provided
  - Net patient service revenue
  - Grants and contracts
  - Donations
- Expenses – costs of providing those services
  - Salaries and fringe benefits
  - Supplies
  - Rent
  - Depreciation
- Excess of revenues over expenses for the period

# Cash Basis versus Accrual Basis of Accounting



- Revenue is not cash collections
- Expense is not cash disbursements
- Example
  - Cash received 100
  - Cash disbursed 80
  - Cash profit 20

  - But accounts receivable 10 and accounts payable 15
  - Revenue (accrual) 110
  - Expense (accrual) 95
  - Profit (accrual) 15

# What to Look For



- Profitability
  - Ratio of excess of revenue to total revenue
    - FY 2009 1.43% compared to 7.42% in FY 2008 and 2.54% in FY 2007. MA CHCs median FY 2008 was 1.66%.
  - Change in revenues
    - FY 2009 compared to FY 2008
    - FY 2009 actual compared to FY 2009 budget
  - Change in expenses
    - FY 2009 compared to FY 2008
    - FY 2009 actual compared to FY 2009 budget

# Balance Sheet reports at a Point in Time



- Assets – things that you own
  - Cash
  - Patient accounts receivable – net of allowance for uncollectible accounts
  - Grants receivable
  - Board designated funds
  - Other restricted funds
  - Property and equipment – net of depreciation
- Liabilities – things you owe
  - Accounts payable
  - Accrued expenses
  - Line of credit
- Net assets – assets minus liabilities
  - Unrestricted
  - Restricted

# What to Look For



- Days cash on hand
  - The number of days you could continue to pay obligations if no additional funds were received
    - At Y/E 2009 29 days compared to 22 days at Y/E 2008 and 29 days at Y/E 2007. MA CHCs median at Y/E 2008 was 30 days.
- Days in patient accounts receivable
  - The average number of days it takes to collect patient receivables
    - At Y/E 2009 68 days compared to 45 days at Y/E 2008 and 52 days at Y/E 2007. MA CHCs median at Y/E 2008 was 49 days.

# What to Look For



- Days in accounts payable
  - The average number of days it takes to pay vendor obligations
    - At Y/E 2009 48 days compared to 41 days at Y/E 2008 and 39 days at Y/E 2007. MA CHCs median at Y/E 2008 was 35 days.
- Leverage ratio
  - The ratio of liabilities to net assets; a measure of reliance on borrowing
    - At Y/E 2009 0.51 compared to 0.45 at Y/E 2008 and 0.46 at Y/E 2007. MA CHCs median at Y/E 2008 was 0.63.

# Statement of Cash Flows



- Sources and uses of cash from
  - Operating activities – e.g., changes in current assets and current liabilities
  - Investing activities – e.g., purchases/sales of property and equipment
  - Financing activities – e.g., increases/decrease in long-term borrowing
- Reconciles accrual basis accounting to cash basis

# What to Look For



- Overall change in cash balance
- Positive cash flow from operating activities
- Significant investing activities
- Significant financing activities

# Board Financial Responsibilities



- Financial priorities
- Long-range financial planning
- Annual budget
- Financial policies and controls
- Review of financial statements
- Independent audit

# Sample Goal, Objective, Task



- Goal: Ensure long-term financial stability
  - Objective 1: Increase the number of new registrants by 20%
    - Task 1: Contact area local schools to provide health services to 200 students
    - Task 2: Hold a health fair to attract residents to the CHC for a net gain in registrants of 150

# Controls



- Signature authority
- Collection policy
- Insurance
- Taxes
- Monthly review of financial information
  - Visit statistics – actual versus budget; trends
  - Revenues and expenses – actual versus budget; trends
  - Explanations of major differences

# Auditors



- Financial statements and system of internal controls are the responsibility of management. Auditors are responsible to express an opinion on the financial statements and system of internal controls
- Report to the Board
- Work includes
  - Report on financial statements
  - Report on internal controls
  - Management letter
- Private meeting

# What to Look For



- “Clean” opinion – “in our opinion the financial statements present fairly”
- Follow-up to prior year management letter and internal control report
- Current concerns described in the management letter and internal control report
- Read the footnotes