VOLUME 13, CHAPTER 7: "FINANCIAL REPORTING"

SUMMARY OF MAJOR CHANGES

Changes are identified in this table and also denoted by blue font.

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by ***bold, italic, blue, and underlined font***.

The previous version dated June 2023 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
All	Updated formatting and hyperlinks to comply with current administrative instructions.	Revision
5.2.1	Added guidance on preparation and submission of Internal Revenue Service (IRS) Form NEC-1099, "Nonemployee Compensation" per IRS guidance.	Addition

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CHAPTER 7

FINANCIAL REPORTING

1.0 GENERAL

1.1 Purpose

This chapter prescribes the standard policies for financial reporting, which are the principal means of communicating accounting information to those activities relying on information for management of their operations.

1.2 Authoritative Guidance

The accounting policies, and related requirements prescribed, are in accordance with the applicable provisions of:

1.2.1. DoD Instruction ***(DoDI) 1015.15***, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources;" and

1.2.2. Financial Accounting Standards Board (***FASB***) Accounting Standards Codification (***ASC***). Users can now access the ASC without charge. This access now includes browsing by topic, searches, and print options.

2.0 RESPONSIBILITIES

2.1 General

The policies in this chapter apply to DoD Nonappropriated Fund Instrumentalities (NAFIs) and their supporting Accounting Offices (AOs). These policies apply to the Military Exchanges, except for policies related to the Nonappropriated Fund Standard General Ledger (NAFSGL).

2.2 DoD Components

The DoD Components are responsible for the fair presentation in the financial reports of financial position, results of operations, and the program and personnel information included. In addition, the DoD Components are responsible for compliance with Nonappropriated Fund (NAF) program laws and regulations.

2.3 AO

The supporting AO is responsible for compiling all the necessary information from accounting and payroll systems, as well as preparation of financial statements and reports. The integrity of those systems, and the accuracy of data produced, are also AO responsibilities. Refer to Chapter 1 for a list of definitions, reporting requirements, and accounting standards.

3.0 FINANCIAL REPORTING

3.1 Financial Statements

The principal financial statements used to convey information to users are the Balance Sheet, Statement of Income and Expense, Reconciliation of Net Worth, and Statement of Cash Flows.

3.1.1. Balance Sheet. The Balance Sheet (also known as Statement of Financial Position) presents a NAFI's financial position as of a specified date. It is sometimes described as a "snapshot" in a point in time that allows the user to see what a NAFI owns as well as what it owes to others. The major components of the Balance Sheet are assets, liabilities, and net worth (equity). Refer to Chapter 3 and FASB ASC Topic 210 for additional information on assets, liabilities, and net worth (equity).

3.1.2. Statement of Income and Expense. A Statement of Income and Expense (also referred to as a profit and loss statement or income statement) provides information about a NAFI's financial performance during a specified period of time, and a summary of a NAFI's profit or loss during the accounting period. The Statement of Income and Expense is used to track revenues and expenses. Refer to Chapter 5 and FASB ASC Topic 220 for additional information on income and expenses.

3.1.3. Reconciliation of Net Worth. The Reconciliation of Net Worth (also known as statement of retained earnings or statement of shareholder equity) provides information about changes to net worth during a specified period of time. It shows the establishment, disestablishment, or consolidation of NAFIs, receipt or distribution of capital, net income or net loss, and prior year material adjustments. Refer to Chapter 3 and FASB ASC Topic 505 for additional information on net worth (equity).

3.1.4. Statement of Cash Flows. A cash flow statement provides information about cash receipts and cash payments of a NAFI during the accounting period. The statement shows how changes in balance sheet and income accounts affect cash and cash equivalents and breaks the analysis down according to operating, investing, and financing activities. Refer to FASB ASC Topic 230 for additional information on preparing the Statement of Cash Flows.

3.2 Footnotes to Financial Statements

Footnotes are an integral part of the financial statements and used to provide additional disclosures to ensure the financial statements are informative and not misleading. When the actual dollar amounts on the financial statements do not provide sufficient information for decision makers, accountants supplement the financial statements with more detailed data in the form of footnotes. Footnotes help management compare the operating results of the current business period with the operating results of previous periods. Fund equity adjustments and significant business closures are examples of occurrences requiring footnotes.

3.3 Format for the Financial Statements

The format presented for the NAFSGL Financial Statement Mapping to the financial statements is maintained on the ***DoD NAF Accounting*** website. The working versions of all statements and notes will include line numbers as shown therein.

4.0 COMPARATIVE ANALYSIS OF FINANCIAL STATEMENTS

Comparative analysis is the study of relationships and trends to determine whether the financial position, results of operations, and the financial progress of the business are satisfactory or unsatisfactory. The objective of any method used to analyze a financial statement is to simplify or reduce the data under review to more understandable terms.

4.1 Analytical Methods and Techniques

Analytical methods and techniques used in analyzing financial statements include the following:

4.1.1. Comparative Balance Sheets, Statements of Income and Expense, Statements of Cash Flows, and Reconciliations of Net Worth (retained earnings) with the following information:

4.1.1.1. Absolute data (dollar amounts);

4.1.1.2. Comparisons expressed in ratios;

4.1.1.3. Increases and decreases in absolute data in terms of dollar amounts;

4.1.1.4. Increases and decreases in absolute data in terms of percentages; and

4.1.1.5. Percentages of total;

4.1.2. Statement of sources and uses of working capital;

4.1.3. Trend ratios of selected and/or related financial and operating data. A trend analysis is performed for each NAFI financial statement. The analysis of the Balance Sheet compares actual to actual, and the percentage of increase or decrease is calculated. The analysis of the Statement of Income and Expense for each activity compares actual to actual as well as actual to the budgeted amounts. The financial statement analysis is made by each activity for items such as sales, cost of goods sold, labor expenses, net income, and all other revenue and expense items with a material financial effect on the activity;

4.1.4. Common size percentages ((amount/base amount) and multiply by 100) from the Balance Sheet, the Statement of Income and Expense, and individual sections of these statements;

4.1.5. Ratios expressing the relationships of items selected from the Balance Sheet, the Statement of Income and Expense, or both statements; and

4.1.6. Statement of variation in net income or gross margin.

4.2 Ratios

The behavior of ratios over a series of accounting periods is indicative of trends and may signal the need for adjustments in the future. Use the ratios/formulas included in subparagraphs 4.2.1 - 4.2.12 to complete the trend analysis explained in subparagraph 4.1.3. The following ratios/formulas are a means of monitoring the efficiency of NAFIs.

4.2.1. Accounts Receivable Turnover. The accounts receivable turnover is the relationship between credit sales and accounts receivable and indicates the liquidity of an activity's receivables. Calculate accounts receivable turnover by dividing net credit sales by the average accounts receivable (Accounts Receivable Turnover = Net Credit Sales/Average Accounts Receivable). The average accounts receivable is the beginning accounts receivable plus the ending accounts receivable, divided by two. Use average accounts receivable monthly balances in the computation, as it gives recognition to seasonal fluctuations. When such data is not available, it is necessary to use the average of the balances at the beginning and end of the year. Prompt collection of receivables reduces the amount of loss from bad debts. Another method is to divide 365 days by the accounts receivable turnover figure to get the average number of days the receivables were on the books.

4.2.2. Acid-Test Ratio. The acid-test ratio, or quick ratio, measures the ability of NAFIs to use quick assets to liquidate current liabilities. The formula to compute the acid-test ratio is to divide quick assets by current liabilities (acid-test ratio = quick assets/current liabilities). Quick assets refer to assets that can be easily converted to cash, or that are already in cash form, including cash, receivables, and current marketable securities. Current marketable securities are those that can be sold within 12 months of the balance sheet date and not incur a penalty. Quick assets equal current assets minus inventory and prepaid expenses. The acid-test ratio should not be less than 1:1. A ratio of 1:1 shows that for every dollar of current debt there is $1 of quick assets available to meet current liabilities. Higher ratios indicate NAFIs have sufficient cash and cash equivalents to pay immediate obligations.

4.2.3. Current Ratio. The current ratio, or working capital ratio, measures the relationship between current assets and current liabilities. It measures the ability of current assets to pay short-term debts. The formula to compute the current ratio is to divide the total current assets by the total current liabilities (Current Ratio = Total Current Assets/Total Current Liabilities). A current ratio of 1.5:1 is considered standard. A smaller ratio indicates high debt. However, if the current ratio is too high, current assets are not being efficiently utilized and should be converted to other useful purposes. A ratio higher than one means that if all current assets can be converted to cash, they are more than sufficient to pay off current liabilities.

4.2.4. Inventory Turnover Ratio. The inventory turnover ratio expresses the relationship between cost of goods sold and the average inventory balance. The formula to compute the inventory turnover is cost of goods sold divided by the average inventory (Inventory Turnover = Cost of Goods Sold/Average Inventory). Average inventory equals beginning inventory plus ending inventory, divided by two. Excess inventory reduces available funds and may increase the cost of insurance, storage, and other related expenses. The inventory ratio for food and beverage operations generally should not exceed 2.5:1 on a monthly basis or 30:1 on an annual basis. A ratio of 1:3 for other sales operations on a monthly basis, or a ratio of 4:1 on an annual basis, is generally considered acceptable and shows about a 3-month inventory supply. A low turnover rate may indicate overstocking, obsolescence, or deterioration. A high turnover rate may indicate inadequate inventory levels, which may lead to a loss in business. Appropriate inventory levels depend on quantity pricing of purchases, shelf life, and restocking lead-time.

4.2.5. Net Income Ratio. The net income ratio measures the rate of return on revenue. The formula to compute the net income ratio is net income divided by total revenue (Net Income Ratio = Net Income/Total Revenue). Calculate net income as total revenues minus total expenses. Refer to DoDI 1015.15 for additional information on net income.

4.2.6. Ratio of Net Sales to Assets. The ratio of net sales to assets measures the efficiency with which NAFIs are using their assets to generate sales. The formula to compute the ratio of net sales to assets is to divide net sales by total assets minus long-term investments (Ratio of Net Sales to Assets = Net Sales/(Total Assets - Long-Term Investments)). In computing the ratio, exclude any long-term investments from total assets, as they do not contribute to sales. If sales can be stated in a common unit, then units of products sold can be used in place of the dollar amount of sales. Assets used in determining the ratio may be the total at the end of the year, the average at the beginning and end of the year, or the average of monthly totals.

4.2.7. Return on Assets Ratio. The return on assets ratio measures a NAFI's ability to generate income with its existing assets. The formula to compute the return on assets ratio is to divide net income by the average total assets (Return on Assets Ratio = Net Income/Average Total Assets). Average total assets are beginning total assets, plus ending total assets, divided by two.

4.2.8. Return on Fund Equity. The return on fund equity measures a NAFI's ability to earn a higher rate of return than is paid for the funds used in operations. The formula to compute the return on fund equity is to divide net income by the average fund equity (Return on Fund Equity = Net Income/Average Fund Equity). Average fund equity is beginning equity, plus ending equity, divided by two.

4.2.9. Turnover of Working Capital. Working capital is a valuation metric calculated as current assets minus current liabilities. The formula to compute the working capital turnover is to divide net sales by average working capital (Turnover of Working Capital = Net Sales/Average Working Capital). Average working capital is ending current assets, minus ending current liabilities, plus beginning current assets, minus beginning current liabilities, divided by two. Current assets include accounts receivable and inventory while current liabilities include accounts payable. These various components are analyzed individually to account for changes from period to period. The turnover of working capital reflects the extent to which NAFIs operate on a small or large amount of working capital in relation to sales.

4.2.10. Fixed Asset Turnover. The fixed asset turnover is the ratio of net sales to the value of fixed assets, and indicates how well the entity uses its fixed assets to generate sales. The formula to compute the fixed asset turnover is to divide net sales by the total property, plant, and equipment, net of accumulated depreciation (Fixed Asset Turnover = Net Sales/Net Property, Plant, and Equipment).

4.2.11. Working Capital to Total Assets. The working capital to total assets ratio is a liquidity ratio that expresses the net current assets or working capital as a percentage of total assets, and measures a company's ability to cover its short-term financial obligations. The formula to compute the working capital to total assets ratio is to divide working capital by total assets (Working Capital to Total Assets = Working Capital/Total Assets).

4.2.12. Return on Total Assets. The return on total assets measures earnings before interest and taxes (EBIT) relative to total net assets, indicating how effectively assets are used to generate earnings before contractual obligations must be paid. The formula to compute the return on total assets is to divide EBIT by total net assets (Return on Total Assets = EBIT/Total Net Assets).

4.3 Comparative Statements

4.3.1. Comparison. Financial statements analyzed on a comparative basis can be much more informative and meaningful. Use comparative statements to complete the trend analysis explained in subparagraph 4.1.3. Sample comparisons include:

4.3.1.1. Comparison of the latest financial statements and relationships between various elements with one or more previous periods;

4.3.1.2. Comparison of the statements and financial relationships with data for other similar activities;

4.3.1.3. Comparison of the statements and financial relationships of two or more divisions or branches of the same activity; and

4.3.1.4. Comparison of information in the statements with preset plans or goals (normally in the form of budgets).

4.3.2. Horizontal Analysis. A comparison of the amounts for the same item in the financial statements of two or more periods is called horizontal analysis. The term is applied because the analysis includes data from year to year rather than as of one date or period of time. In computing the percent of change, the amount for the earlier year serves as the base. In general, the percentage of change is of greater interest than the actual amounts.

4.3.3. Vertical Analysis. The amount of each item in a statement can be expressed as a percentage of the total. Compare percentages resulting from vertical analysis across two or more periods to discover trends over time.

5.0 REPORTING TO THE INTERNAL REVENUE SERVICE (IRS)

5.1 General

Retain all records relating to payments to individuals and firms according to the ***IRS Topic Number 305***, "Recordkeeping." Continental United States (CONUS) offices consult their local IRS office for forms, publications, or assistance. Overseas offices contact the IRS to get the address and telephone number of the nearest IRS representative. IRS representatives, in CONUS and overseas, provide instructions concerning IRS procedures for return preparation, filing, and depositing employment tax payments. Use electronic reporting mechanisms when possible.

5.2 Contract Payments (Non-personal Services)

* 5.2.1. Nonemployee Compensation. Report to the IRS cumulative NAFI service contract payments made during the calendar year, along with the total amounts paid, which meet the IRS threshold for reporting income on ***IRS Form 1099-NEC***, "Nonemployee Compensation." Include the name, address, and Social Security number of the individual. For businesses, report the amount paid, the business name, business address, and business tax identification number. NAFI contracts with entertainers are considered service contracts. If a single payment to an individual is less than the IRS threshold, but total payments made during the calendar year to the same individual reach the IRS threshold, report the information to the individual or firm, and the IRS, using 1099-NEC. Payment data in various payment systems, for the same contractor, must be consolidated to determine if an entity meets the IRS threshold for reportable payments. The individual or firm receives a copy of the 1099-NEC by January 31 of the calendar year following the calendar year in which payment was made. This applies to individuals who, in addition to being NAFI employees, have contracts with NAFI for non-personal services. Prepare a separate 1099-NEC for each individual or firm to whom total payments meeting the IRS threshold are made. Use ***IRS Form 1096***, "Annual Summary and Transmittal of U.S. Information Returns," for submitting paper forms, or electronically transmit to the IRS the following year in accordance with IRS guidance.

5.2.2. Miscellaneous Income. Report to the IRS cumulative NAFI service contract payments made during the calendar year, along with the total amounts paid, which meet the IRS threshold for reporting income on ***IRS Form 1099-MISC***, "Miscellaneous Income." Include the name, address, and Social Security number of the individual. For businesses, report the amount paid, the business name, business address, and business tax identification number. If a single payment to an individual is less than the IRS threshold, but total payments made during the calendar year to the same individual reach the IRS threshold, report the information to the individual or firm, and the IRS, using 1099-MISC. Payment data in various payment systems, for the same individual or vendor, must be consolidated to determine if an entity meets the IRS threshold for reportable payments. The individual or firm receives a copy of the 1099-MISC by January 31 of the calendar year following the calendar year in which payment was made. Prepare a separate 1099-MISC for each individual or firm to whom total payments meeting the IRS threshold are made. Use IRS Form 1096, for submitting paper forms, or electronically transmit the 1099-MISC to the IRS the following year in accordance with IRS guidance.

5.3 Gambling and Bingo Winnings

IRS reporting requirements for gambling and bingo winnings are tied to individual games. Unlike contract payments, winnings are not accumulated from game to game; each game stands alone for IRS reporting requirements. Whenever cash, merchandise, or a combination thereof, meeting the IRS threshold for reportable gambling winnings, is awarded to a person for winning a single bingo game or other gambling activity, prepare an ***IRS Form W-2G***, "Certain Gambling Winnings." Individuals receive their copies of the IRS Form W-2G at either the time payment is made, or not later than January 31 of the following year. Use IRS Form 1096 to transmit W-2Gs to the IRS. Additionally, prepare ***IRS Form 1042-S***, "Foreign Person's U.S. Source Income Subject to Withholding," for reporting foreign nationals' gaming winnings and withholdings. Transmit the forms to the IRS the following year in accordance with IRS guidance.

6.0 INTERNATIONAL BALANCE OF PAYMENTS (IBOP) PROGRAM

IBOP is an accounting of a country's international transactions for a particular period of time. NAFIs are subject to the IBOP reporting guidance prescribed in ***DoDI 4105.67***, "Nonappropriated Fund (NAF) Procurement Policy and Procedure," and Volume 6A, Chapter 13.