Accounting Reports and Analysis

Accounting is recording and reporting for making decisions. Used by resource providers/recipients and governing bodies. First focus of a financial statement being prepared is to satisfy **primary users** (investors/lenders).

NB: **profitability** is a percentage return on investment rather than a pure dollar figure (profit). **Gearing** is a synonym for Capital Structure.

Accounting provides information both to **internal users** (management accounting) as well as **external users** (stakeholders outside of the entity). The preparation of General Purpose Financial Report seeks to provide information to these external users (financial accounting).

Summary of information needs

- Financial
  - Profitability (utilisation of resources to generate returns)
  - Efficiency (the ability to generate cash flow)
  - Liquidity (the ability to meet short-term debts)
  - Gearing (the financial structure)
  - Market performance (share prices, earnings)
- Non-financial
  - Corporate governance / compliance
  - Social and environmental impact (CSR reporting)

General Purpose Financial Report

Contain Statement of Profit or Loss, Balance Sheet, Statement of Cash Flows, Statement of Changes in Equity (all these are known as General Purpose financial statements) as well as Notes to the Accounts (very important).

JB Hi-Fi Ltd

STATEMENT OF PROFIT OR LOSS
for the financial year ended 30 June 2015

	Note	Consolidated 2015 $'000	Consolidated 2014 $'000
Revenue	3	3,652,136	3,483,775
Cost of sales		(2,853,883)	(2,727,794)
Gross profit		798,253	755,981
Other income		631	520
Sales and marketing expenses		(374,084)	(355,694)
Occupancy expenses		(160,216)	(148,969)
Administration expenses		(27,711)	(27,600)
Other expenses		(36,414)	(32,716)
Finance costs	4	(5,927)	(8,845)
Profit before tax		195,532	182,677
Income tax expense	5	(59,021)	(54,230)
Profit for the year		136,511	128,447

Includes who, what, when?

Show the previous year as well (known as comparatives)

All the expenses are bracketed
Each item in the sheet is referred to as a line item (note the important aspects are boldened)
Balance sheets are dated at a specific point in time, income statements are over a period.

The below balance sheet includes both assets and liabilities.

$$\boldsymbol{Assets - Liabilites = Net\ Assets}$$

JB Hi-Fi Ltd

BALANCE SHEET
as at 30 June 2015

	Note	Consolidated 2015 $'000	Consolidated 2014 $'000
ASSETS			
Current assets			
Cash and cash equivalents		49,131	43,445
Trade and other receivables	9	81,480	70,745
Inventories	10	478,871	458,625
Other current assets	11	7,416	5,332
Total current assets		616,898	578,147
Non-current assets			
Plant and equipment	12	176,208	181,564
Deferred tax assets	13	17,363	14,909
Intangible assets	14	84,541	85,218
Other financial assets		3	3
Total non-current assets		278,115	281,694
Total assets		895,013	859,841
LIABILITIES			
Current liabilities			
Trade and other payables	15	325,604	302,979
Provisions	16	40,585	36,840
Other current liabilities	17	4,566	4,111
Current tax liabilities		9,474	8,184
Other financial liabilities		107	79
Total current liabilities		380,336	352,193
Non-current liabilities			
Borrowings	18	139,461	179,653
Provisions	19	6,073	8,699
Other non-current liabilities	20	25,664	24,638
Other financial liabilities		–	25
Total non-current liabilities		171,198	213,015
Total liabilities		551,534	565,208
Net assets		343,479	294,633
EQUITY			
Contributed equity	21	56,521	58,383
Reserves	22	17,636	16,265
Retained earnings		269,322	219,985
Total equity		343,479	294,633

	Sole trader	Partnership	Company
Set up & administration	Straight forward	Relatively straight forward	Complex
Life of entity	Limited to life or desire of owner	Limited to life or desire of individual partners	Indefinite
Legal status relative to owners	Not separate	Not separate	Separate
Extent of owners' liability	Unlimited	Unlimited	Limited (with some exceptions)
Tax implications	Owner declares profit as income	Partner declares share of profit as income	Entity taxed on profit, shareholders declare dividends as income

Common to all these entities is that entity and the owners are separate reporting entities.
Corporations Act 2001 stipulates that there are two types of companies: **public and proprietary** (private).

Public Companies (Ltd. Or LLC.)

Must have shareholders (not necessarily listed).
No restrictions on raising capital or transfer of ownership. Level of liability can change for different companies.

Proprietary Company (Pty. Ltd.)
Have less than 51 shareholders, restrictions on raising capital from public and transfer of ownership.
Defined as either large or small depending on the following three thresholds (large≥2, small <2):
Revenue of $25m for the financial year Gross assets of $12.5m at the end of FY 50 EFT employees at the end of FY.

Public companies or large proprietary companies must issue full financial reports. Small proprietary companies have significantly reduced reporting requirements. These reports must comply with **accounting standards** and also show a **true and fair** view of financial position and performance. International Accounting Standards known as **IFRS**.

<u>Conceptual Framework</u>
The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

General Purpose Financial Reports (GPFRs)

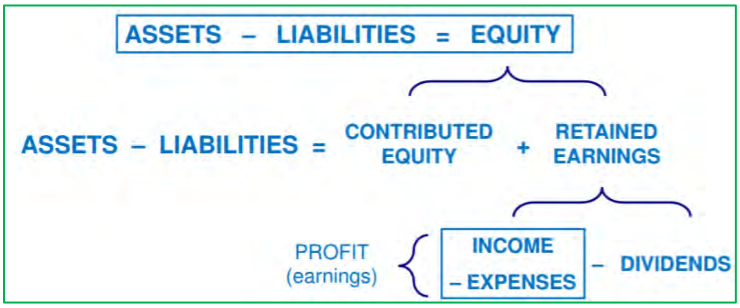
Focuses on resources and claims (both as they currently stand and as they have changed over the past years). Hence need income statement, balance sheet, cash flow statement, statement of changes in equity in order to provide all the information required by users.
Accrual accounting recognises all exchanges (whether that be cash or credit) and deals with other economics phenomena as well (such as depreciation).
Qualitative Characteristics of Useful Financial Information (both 2 fundamental and 4 enhancing)
Relevance/Materiality, Faithful Representation, Comparability, Verifiability, Timeliness and Understandability.

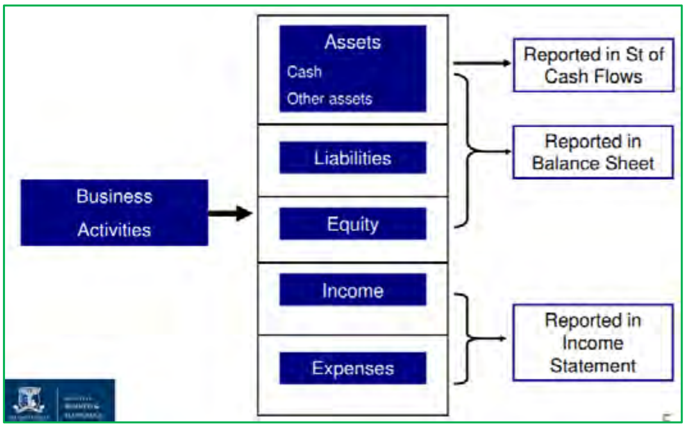
- Relevance and Materiality are both judgement-based concepts, since both vary greatly according to who is reading the statement, basically information that could shape an investors decision must be included.
- Faithful Representation stipulates that info must be complete, neutral and free from error (not necessarily accurate), i.e.. Managers must act reasonably in their preparations.
- Comparability implies consistency across entities and time periods. Verifiability means that information can be verified either through publicly accessible info or total disclosure of methodology.
- Timeliness represents the trade-off between accuracy and getting it done. Understandability is the attempt to avoid unnecessary complexity and provide clear and concise information.

Despite these reports being extraordinarily expensive, there are benefits associated with quality reports, as below:

<u>5 Elements of Financial Statements</u>
Assets are controlled as a result of past events and have a future economic benefit (not necessarily monetary) that is expected to flow to the entity.
Liabilities are present obligations which is expected to result in an outflow embodying economic benefits. (future commitments are not necessarily present obligations). POs occur when at the wrong end of a lopsided transaction.
Equity is the difference between assets and Liability, not really reflective of value.
Income occurs when equity is positive, i.e.. When assets increase by more than liabilities then there is income. (except for investment by shareholders, which is considered a direct contribution).
Expenses are the opposite of income, when liabilities increase by more than assets. (<u>different</u> from assumed definition, i.e.. Buying a car is not an expense, less cash but more car).

In order for any of the above elements to be included in the balance sheet, they must be recognised by the following criteria:
It is <u>probable</u> that any future economic benefit flow will occur (either to or from the entity).
The item also must have a cost or value that can be measured with <u>reliability.</u> (a dollar figure).
Therefore in order for an asset or liability to be recognised in the balance sheet, it must be probable that the FEB will flow to/from the entity and that its value can be measured reliably. Hence, income and expenses are satisfied if the assets and liabilities are also satisfied.





Asset – anything with future benefit, unused or left over
Liability – anything owed
Equity – anything to do with owners
Income - anything earned
Expense – used up/consumed

Assets	$	Liabilities	$
Cash on hand	40,000	Trade payables	15,000
Inventory	25,000	Loan	60,000
PPE	30,000	Total liabilities	75,000
		Equity	
		Contributed equity	20,000
	95,000		95,000

Example: (note the duality in all these transactions)

Transaction and events during June 2016 Transaction and events during June 2016

♣ Issued shares for $20,000 (cash up 20k - asset, contributed equity up 20k - equity)

♣ Received $60,000 from a bank loan (cash up 60k - asset, loan up 60k - liability) – no need to allow for interest since not a **PRESENT** obligation.

♣ Arranged a lease for $2,000 per month (nothing to record since equally unperformed contract at this stage) phenomenon of business events vs business transactions.

♣ Purchased fixtures & fittings for $30,000 cash (Property, Plant Equipment up 30k – asset, cash down 30k -asset)

♣ Bought inventory for $25,000 (cash $10,000) (inventory up 25k – asset, cash down 10k – asset, trade payables up 15k – liability) note: trade payables mean the item is used in the standard money-making operations of the firm.

The gallery opened for business on 1 July 2016 and the following is a summary of transactions and events for the 2017 financial year:

1. Paid advertising $7,000
2. Purchased additional fixtures and fittings for cash $20,000 Adele and Randall installed the fixtures and fittings
3. Purchased more inventory on credit $40,000
4. Rent payments were $26,000 which included the payment of July 2017's rent in advance
5. Sold art pieces to customers for $150,000 of which $55,000 was collected in cash immediately and $95,000 was sold on credit
6. The pieces sold above cost *ARA Galleries* $50,000
7. Paid utilities of $8,000
8. Paid wages $32,000. A further $1,000 of unpaid wages was owed on June 30.
9. Received $65,000 that was owed by credit customers
10. Loan repayments were $13,000 of which $3,000 was interest and $10,000 was principal
11. Paid suppliers $35,000 that was owing from previous credit purchases of inventory
12. Depreciation of fixtures & fittings was $5,000 for the year
13. Paid a total dividend of $10,000 to shareholders
14. Income tax owing at the end of the year is $6,000

Profit = Revenue – Expenses (doesn't include dividends)

Cash	T/Rec	Inventory	Other CA	PPE	T/Pay	Other CL	Loan	Cont Eq	Retained earnings		
									Opening balance		-
40	-	25	-	30	15	-	60	20	Revenue	Expenses	Div
(7)										(7)	Adv
(20)				20							F&F
		40			40						Inv
(26)			2							(24)	Rent
55	95								150		Sales
		(50)								(50)	CoS
(8)										(8)	Utils
(32)						1				(33)	Wages
65	(65)										A/R
(13)							(10)			(3)	L & Int
(35)					(35)						A/P
				(5)						(5)	Depn
(10)											(10)
						6				(6)	Tax
9	30	15	2	45	20	7	50	20	150	(136)	(10)
									Closing balance		4

• **Net profit** measures the difference between all revenue and all expenses.

• **Gross profit** measures the difference between the revenue generated from selling goods (i.e. Sales) and the cost of that inventory sold (i.e. Cost of sales) – Note: the cost of the inventory sold, not purchased

ARA Galleries Pty Ltd

Statement of profit or loss for the year ended 30 June 2017

	$
Sales revenue	150 000 *
Cost of sales	(50 000)
Gross profit	**100 000**
Wages	(33 000)
Rent	(24 000)
Utilities	(8 000)
Advertising	(7 000)
Depreciation	(5 000)
Finance costs	(3 000) *
Profit (loss) before tax	**20 000**
Income tax expense	(6 000) *
NET PROFIT (LOSS)	**14 000** *

Convention is to list expenses in order of magnitude (in synch with relevance)

Alternative line descriptors:
- Selling expenses
- Administrative expenses
- Occupancy expenses
- Finance expenses

Preparing Financial Statements

All need who, what, when? (DO NOT abbreviate dates, write in full i.e.. 30 June 2017) (spaces between 1000s)

All income statements must disclose at least: profit/loss, revenue, finance costs, tax expense and other additional important line item (gross profit/wages/loan/rent etc.) Line