Lesson resource
Interpreting accounts – ACCA

Transactions are the heart of a business. Each one is recorded through invoices and receipts. These are carefully classified and combined to form the accounting statements that the managers and other stakeholders in a business require. A stakeholder is anyone with an interest in or an influence upon the business and its activities. First, there are the owners and managers. If they are to keep adding value then they need to monitor and track every use and flow of resources. Accounts contain a detailed history of how the business has used its resources. This is part of the firm's accountability.

The published accounts tell shareholders how their capital has been managed. They help lenders, investors and suppliers to judge the company's reliability in keeping to agreements and meeting obligations, showcasing the company's performance in meeting its obligations. The publication of accounts is a legal requirement. A public company (a plc) must provide a full range of accounting statements including:

- the Income Statement
- the Balance Sheet
- the Cash Flow Statement.

The Income Statement

The Income Statement, often issued at quarterly intervals, is important to managers in revealing trends for sales and costs – both broken down under much more detailed headings. The Income Statement may also be studied by creditors. Creditors are other firms supplying goods or lending money. They want to see if the business looks creditworthy since limited liability means that they might not be repaid if the company collapsed.

The Balance Sheet

We need to relate profit to the value of resources used in its generation. So, what is the value of the resources contained within a business? And how were they financed? These are the two essential questions answered by the Balance Sheet. They are also the questions that explain the basis of the term 'Balance Sheet'. The total value of resources must 'balance' with the sources of finance used in obtaining those resources.

Careful reading of a company's Balance Sheet can be highly revealing. The difference between current assets and current liabilities is called net current assets or working capital. This indicates the extent to which the business has everyday funding to keep trading and not to run out of cash. By contrast, capital employed is a measure of the long-term resources in use by the business.

The Cash Flow Statement

A healthy business generates a continuous flow of cash through its trading operations. Every business needs cash to pay for its on-going expenses and to settle debts as they arise. Running out of cash would mean being unable to make these payments. This could lead to a business entering into liquidation. The Cash Flow Statement tracks how cash has moved into and out of the business over the preceding year. It reveals how much cash was generated from inside the business (e.g. sales) and how much was obtained from external finance (e.g. loans).

The Cash Flow Statement is important to managers but also to shareholders, creditors and employees. Too much cash is wasteful since it should be invested for the best returns. On the other hand, running short of cash can be a threat to the very survival of the business.

Questions

1. Describe the main purpose of accounting documents.

2. Explain why the shareholders of a PLC will be interested in the published accounts of the business.

3. Evaluate the importance of accounting documents in developing a business strategy.

4. Analyse why it is important that accounting documents are accurate.

Task

Obtain the accounts of a UK Public Limited Company (usually available from their website) and then prepare and deliver a presentation that analyses:

- Their Income Statement
- Their Balance Sheet
- Their Cash Flow Statement
- Their overall financial position

What have you learned?

Expectations: List at least three pieces of information that you would expect to find on each of the accounting documents referred to in the case study (Income Statement, Balance Sheet, and Cash Flow Statement). For each piece of information briefly explain why the information is useful to stakeholders.