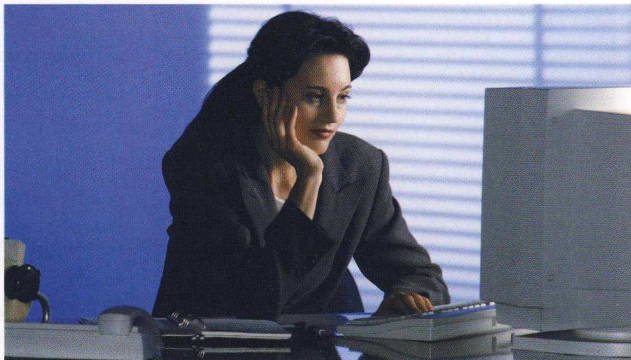


33 Measuring performance

A Financial reporting



Maria Malone is the chief finance officer of a large international media company, based in the UK, with activities in television and publishing. She's talking to new trainees in the finance department:

'As with all companies, investors and analysts want to know how the company is being run and how their money is being used. Each year we produce an **annual report** with three key sets of figures:

- profit and loss account
- balance sheet
- cashflow statement

These are the three key **financial statements** in **financial reporting**. They give the basic information about our **financial results**.' (They are covered in Units 34–37.)

B The financial year

'Our **financial year** ends on March 31st, although other companies choose other dates. Soon after this, we publish **preliminary results**, or **prelims**. The **full report and accounts** are published a few months later. As a UK company, we also publish **interim results** or **interims** after the first six months of our financial year.'

Note: US companies publish their results every **quarter**.

C Shareholders, bondholders and lenders

'We use **shareholders**' money to operate and invest in the business. Some of the profit we make is paid out to them, usually in the form of **dividends** in relation to the number of **shares** that they each hold. Our shares are **traded** on the London **stock market**.

We also borrow money in the form of **bonds**. We pay percentage **interest** on those bonds and then later repay the **principal**, the amount of money originally lent to us. Our bonds are traded on **bond markets**.

And we borrow money from banks in the form of **loans**, on which we also pay interest.

Of course, our shareholders, **bondholders** and **lenders** all take a keen interest in our accounts!

The results we publish can affect share prices: good results cause prices to rise, if the market believes the company is **undervalued**. However, poor results often cause a drop in share price, as investors feel the company is **overvalued**.'

BrE: shareholder;
AmE: shareholder / stockholder

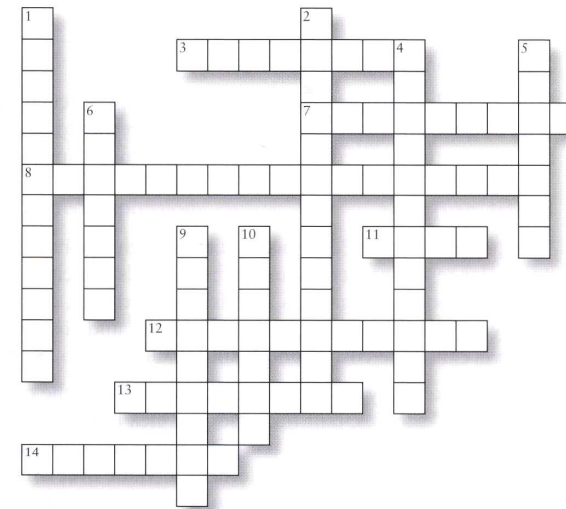
33.1 Complete the crossword with appropriate forms of expressions from A, B and C opposite.

Across

- 3 Reports that are not for the full year. (8)
- 7 and 6 down What investors are basically interested in. (9,7)
- 8 One of the three key financial statements. (8,9)
- 11 Money lent by a bank. (4)
- 12 People and institutions that own bonds. (11)
- 13 The money you pay on a loan. (8)
- 14 See 2 down.

Down

- 1 Another of the three key financial statements. (7,5)
- 2 and 14 across Another of the three key financial statements. (6,3,4,7)
- 4 Together, these people and institutions are the owners of the company. (12)
- 5 Period of three months. (7)
- 6 See 7 across.
- 9 The publication of results: financial (9)
- 10 Banks and others that loan money. (7)



33.2 Complete the table with words from B and C opposite and related forms. Put a stress mark in front of the stressed syllable in each word of more than one syllable. (The first one has been done for you.)

Verb	Noun – thing	Noun – person/organization
'borrow	'borrowing	'borrower
finance		
lend		

33.3 Complete the sentences with appropriate forms of 'finance'. (There are two possibilities for one of the gaps.)

- 1 A millionaire donated a large sum to the charity.
- 2 The for the project is coming from two different sources: bank loans and a new share issue.
- 3 The company must keep a careful control on its this year in order to avoid making a loss.

Over to you



Obtain the annual report of an organization you are interested in. (Many are available on the Internet at www.carol.co.uk. You can also use this source for other units on Company Finance.) Identify the profit and loss account (or the income statement), the balance sheet and the cashflow statement. What other information does the report contain?

34 Profit and loss account

A Accruals accounting

Maria Malone continues:

'The **accruals principle** means that events in a particular **reporting period**, for example sales of goods or purchases of supplies, are recorded in that period, rather than when money is actually received or paid out; this may happen in a later period.'

B Profit and loss

'The **profit and loss (P&L) account** records the money we make (or lose!) during a particular reporting period, using the accruals principle. In our case, our accounts record sales from books, magazines, television advertising, etc. during the period – this is the money received from sales, minus the labour and cost of materials used to produce them, which is called the **cost of goods sold (COGS)**.

Then we take away **selling and general expenses** – the costs related to making these sales – employees' salaries, rent for buildings, etc. There is also the cost of **depreciation** – this is not an actual sum of money paid out, but is shown in the accounts to allow for the way that machinery wears out and declines in value over time and will have to be replaced. (See Unit 35) This leaves us with our **operating profit**.

Then we subtract the **interest payable** on money we have borrowed in the form of bonds and bank loans. This gives the **profit on ordinary activities before tax**, or **pre-tax profit**.

Sometimes there are **exceptional items** to report, for example the cost of closing a particular operation, but fortunately this does not happen very often.

Of course, we pay tax on our profits and in the UK this is called **corporation tax**.

Note: Sales are also referred to as **turnover** in BrE. The profit and loss account is called the **income statement** in the USA.

C Earnings

'From the **profit after tax**, also referred to as **earnings**, we usually pay **dividends** to shareholders, and you can see the figure for **dividends per share**. However, when business is bad, we may not do this – we may **omit**, **pass** or **skip the dividend**.

Naturally, we don't pay out all our profit in dividends. We keep some to invest in our future activities – these are **retained earnings**, or **reserves**.

You can look at profitability in terms of **earnings per share (EPS)**, even if some of these earnings are retained and not paid out in dividends.'

34.1 Match the words in the box to make expressions from A, B and C opposite. (The first one has been done for you.)

accruals	periods	exceptional	earnings	items	account
interest	payable	operating	P&L	profit	
reporting	retained	expenses	principle	selling and general	

Now complete each sentence with the correct expression.

- 1 Our financial year runs from 1 April to 31 March and is made up of two six-month
- 2 The company's has increased by 10 per cent this year.
- 3 We have decided to keep £25,000 from our profits as and not distribute this to the shareholders.
- 4 One of the in the profit and loss account this year related to the restructuring costs of our operations in Korea.

34.2 Read the profit and loss account for a UK company. Then look at A, B and C opposite and say if the statements below are true or false. All figures are pounds sterling.

Paradigm Manufacturing		Profit and loss account for the year ended 31 March 20__	
Sales	900,000		
Cost of goods sold		560,000	
Selling and general expenses		120,000	
Depreciation		18,000	
Operating profit			202,000
Interest payable		15,000	
Pre-tax profit			187,000
Exceptional items*		57,000	
Corporation tax		60,000	
Profit after tax			70,000
Dividends		25,000	
Retained earnings			45,000

There are 100,000 ordinary shares. Earnings per share: 70 pence. Dividends per share: 25 pence.
*This is for costs related to the closure of our offices in Stockholm.

- 1 The £120,000 for selling and general expenses includes the salaries of the salesforce.
- 2 The £18,000 for depreciation represents an actual amount of money paid out to suppliers.
- 3 The company has a bank loan and/or is paying interest to holders of its bonds.
- 4 £57,000 for exceptional items is probably paid out every year.
- 5 The company has paid out more to shareholders this year than it has kept for future investment and/or future payouts.

Over to you

Obtain the annual report of an organization you are interested in. Relate what you find in the profit and loss account or income statement with the items in the table above. Then compare the figures with those for the previous year. What differences can you see?

35 Balance sheet 1

A Assets

A company's **balance sheet** gives a 'snapshot picture' of its assets and liabilities at the end of a particular period, usually the 12-month period of its financial year. But the snapshot could be taken on any day of the year.

An **asset** is something that has value or the power to earn money for a business. Assets include:

1 current assets:

- **cash** at the bank.
- **securities:** investments in other companies.
- **stocks, of raw materials, unfinished goods and finished goods,** that are going to be sold.
- **debtors:** money owed to the company by customers.



fixed assets

- 2 **fixed or tangible assets:** equipment, machinery, buildings, land.
- 3 **intangible assets:** for example, **goodwill**, the value that the company thinks it has as a functioning organization with its existing customers, and in some cases **brands** (see Unit 26), because established brands have the power to earn it money, and would have a value for any potential buyer of the company.

However, there are some things of value that are never shown on a balance sheet, for example the knowledge and skills of the company's employees.

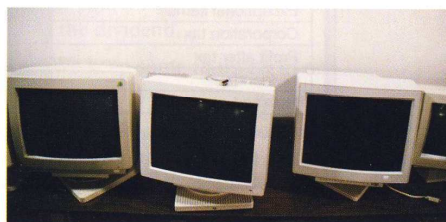
BrE: stocks, AmE: inventories; BrE debtors, AmE accounts receivable / receivables

B Depreciation

Of course, some assets such as machinery and equipment lose their value over time because they **wear out** and become **obsolete** and out of date. Amounts relating to this are shown as **depreciation** or **amortization** in the accounts. For example, some computer equipment is **depreciated** or **amortized** over a very short period, perhaps as short as three years, and a **charge** for this is shown in the accounts. The value of the equipment is **written down** or reduced each year over that period and **written off** completely at the end.

The amount that is shown as the value of an asset at a particular time is its **book value**. This may or may not be its **market value**, i.e. the amount that it could be sold for at that time. For example, land or buildings may be worth more than shown in the accounts because they have increased in value. Equipment may be worth less than shown in the accounts because its value has not been depreciated by a realistic amount.

Note: The terms 'depreciate' and 'depreciation' are usually used in the UK; 'amortize' and 'amortization' are more common in the USA.



Computer equipment is usually depreciated over three years.

35.1 Complete the assets table for a UK company with expressions from A opposite, and the relevant figures, using the following information:

- Paradigm has goodwill, in the form of hundreds of satisfied customers, worth an estimated £15,000. This is its only intangible asset.
- It has investments of £6,000 in other companies.
- It has raw materials, unfinished goods and finished goods together worth £3,500.
- It owns equipment and machinery with a book value of £9,000.
- It owns land with a book value of £31,000.
- It has £11,000 in its accounts at the bank.
- It owns offices and factories with a book value of £94,000.
- Various people and organizations, including customers, owe £7,500.

Paradigm Manufacturing Balance sheet at 31 March 20__			
ASSETS			
Cash			
	6,000		
Total current assets		28,000	
	94,000		
Total fixed assets (book value)		134,000	
Total intangible assets		15,000	
TOTAL ASSETS			177,000

35.2 Using the information in B opposite and in the table above, decide if these statements about Paradigm's assets are true or false.

- 1 The figure for equipment and machinery is the price it was bought for, written down by an amount for depreciation.
- 2 The figure for equipment and machinery shows that it has been written off completely.
- 3 The figure for land and buildings is the exact amount they could definitely be sold for.
- 4 The figure for goodwill is an objective value of the customer base that a buyer of the company would definitely agree to pay.

Over to you



Think of an organization you are interested in. What are its main assets? Which of them could be shown on its balance sheet?

36 Balance sheet 2



A Liabilities

A company's **liabilities** are its debts to suppliers, lenders, bondholders, the tax authorities, etc.

Current liabilities are debts that have to be paid within a year, for example:

- **creditors:** money owed to suppliers etc.
- **overdrafts:** when the company spends more money than it has in its bank accounts.
- **interest payments** that have to be paid in the short term.
- **tax payable.**

Long-term liabilities are debts that have to be paid further into the future, for example long-term **bank loans** and **bonds**.

BrE: creditors;
AmE: accounts payable or payables

B Shareholders' funds

When you deduct a company's **liabilities** (everything it owes) from its assets (everything it owns), you are left with **shareholders' funds**¹. In theory, this is what would be left for shareholders if the business stopped operating, paid all its debts, obtained everything that was owed to it and sold all its buildings and equipment.

Shareholders' funds as shown in a company's accounts includes:

- The **share capital**² the shareholders have invested.
- The profits that have not been paid out in dividends³ to shareholders over the years, but have been kept by the company as **retained earnings**, also called **reserves**.

BrE: shareholders' funds
AmE: shareholders'/owners' equity

36.1 This is the other half of the balance sheet in Unit 35. Complete the assets table with expressions from A and B opposite, and the relevant figures, using the following information:

- Paradigm has a bank loan of £20,000 to be repaid in three years.
- It has issued £100,000 worth of shares.
- It has issued bonds for £30,000 that it will have to repay in seven years.
- It has retained earnings of £10,500.
- It has to pay £3,500 in interest on its bank borrowing and bonds.
- It owes £5,000 in tax.
- It owes £6,000 to suppliers and others.
- On one of its bank accounts, Paradigm has spent £2,000 more than it had in the account.

paradigm Manufacturing Balance sheet at 31 March 20__			
LIABILITIES			
	6,000		
	5,000		
Total current liabilities		16,500	
Bank loan repayable in 3 years			
Total long-term liabilities		50,000	
Shareholders' funds		110,500	
TOTAL LIABILITIES PLUS SHAREHOLDERS' FUNDS			177,000

36.2 Using the information in B opposite and in the table above, decide if these statements about Paradigm's liabilities are true or false.

- 1 The creditors item includes debts that will have to be paid in two or three years.
- 2 Overdrafts are a form of long-term loan.
- 3 In the coming year, Paradigm will have to pay more tax than it pays out in interest on its loans.
- 4 Paradigm has borrowed more in the form of bonds than in the form of bank loans.
- 5 Share capital of £100,000 is the current value of Paradigm's shares on the stock market.
- 6 Retained earnings is the total of all the dividends that have been paid out to shareholders over the years.

Over to you

Obtain the annual report of an organization you are interested in. Relate where possible the items on the liabilities side of its balance sheet with the items in the table above.