

3

SHEETS



How to understand finance documents

A quick explanation of profit & loss, cash-flow statements and balance sheets.

Lots of people have difficulty in remembering what the three big financial accounting documents do, how you read them, and in understanding how they work together. We are going to give you a brief explanation of each, and then show you how they work together using the example of depreciation. Don't worry, it's actually quite straight forward. We have also added a little exercise at the end to really make you think and improve your understanding of these three key documents.

1

Profit & Loss Statement

The Profit and Loss (P&L) Statement is a financial summary of the revenues earned (income) and the expenses incurred (costs) by a company over a period of time.

The basis for the P&L Statement is:

$$\text{Sales} - \text{Cost of Goods Sold} = \text{Gross Margin/Profit} - \text{Operating Expenses} - \text{Income Taxes} = \text{Net Income/Profit}$$



How to relate to a P&L statement

	Company	You
Total income	Gross Sales	Total Salary
Less	(Discounts)	(Income Tax)
Less	(Samples, Coupons, Incentives)	(Pension Contribution)
Less	(Excise Tax)	(National Insurance)
Equals	Net Sales Value	Net Salary Value
Less	(Cost of goods sold)	(Entertainment / Lifestyle)
Equals	Gross Profit	Gross Profit
Less	(Trade Spend / Advertising & Promotion)	(Education)
Equals	Contribution after Trade Spend / Advertising & Promotion	Contribution after Education
Less	(Overheads)	(Fixed Cost of Living)
Equals	Operating Profit	Operating Profit
Less	(Taxes)	(Savings)
Equals	Profit for the year	Net Income

An example P&L Statement

	Notes	Year ended 30 June 2007 £ million	Year ended 30 June 2006 £ million	Year ended 30 June 2005 £ million
Sales	2	9,917	9,704	8,968
Excise duties	3	(2,436)	(2,444)	(2,291)
Net sales		7,481	7,260	6,677
Cost of sales	3,5	(3,003)	(2,921)	(2,632)
Gross profit		4,478	4,339	4,045
Marketing expenses	3	(1,162)	(1,127)	(1,013)
Other operating expenses	3,5	(1,157)	(1,168)	(1,301)
Operating profit	2	2,159	2,044	1,731
Sale of General Mills and other businesses	5	(1)	157	214
Interest receivable	6	111	51	121
Interest payable	6	(362)	(244)	(271)
Other finance income	6	55	24	26
Other finance charges	6	(16)	(17)	(17)
Share of associates' profits after tax	7	149	131	121
Profit before taxation		2,095	2,146	1,925
Taxation	8	(678)	(181)	(599)
Profit from continuing operations		1,417	1,965	1,326
Discontinued operations	9	139	-	73
Profit for the year		1,556	1,965	1,399
Attributable to:				
Equity shareholders of the parent company		1,489	1,908	1,344
Minority interests		67	57	55
		1,556	1,965	1,399
Basic earnings per share	10			
Continuing operations		50.2p	67.2p	42.8p
Discontinued operations		5.2p	-	2.4p
		55.4p	67.2p	45.2p
Diluted earnings per share	10			
Continuing operations		49.9p	66.9p	42.8p
Discontinued operations		5.1p	-	2.4p
		55.0p	66.9p	45.2p
Average shares		2,688m	2,841m	2,972m

2

Balance Sheet

The Balance Sheet is a financial “snapshot” at any given point in time, used to evaluate the financial health or net worth of the business.

The basis for the Balance Sheet is:

$$\text{Assets} = \text{Liabilities} + \text{Shareholder's Equity}$$

How to relate to a Balance Sheet statement

Company	
Assets	Liabilities
Current Assets	Current Liabilities
Cash	Creditors (those you owe money)
Debtors (those who owe you money)	Wages Payable
Stock	Total Current Liabilities
Prepaid Insurance	Long Term Liabilities
Total Current Assets	Borrowings payable (Loans)
Fixed Assets	Total Long Term Liabilities
Property & Equipment	Total Liabilities
Less Accumulated Depreciation	Shareholders Equity
Total Fixed Assets	Organisation Net worth
Total Assets	Total Liabilities and Shareholders Equity

You	
Assets	Liabilities
Current Assets	Current Liabilities
Cash	Creditors (Utility bills, credit card bills)
Debtors (Tax refund!)	Wages Payable (Baby sitter's fees)
Stock (Furniture, collectables, IT, freezer contents)	Total Current Liabilities
Prepaid Insurance (Home owners)	Long Term Liabilities
Total Current Assets	Borrowings payable (Loan for vehicle purchase)
Fixed Assets	Total Long Term Liabilities
Property & Equipment (Home)	Total Liabilities
Less Accumulated Depreciation	Shareholders Equity
Total Fixed Assets	Your Net worth
Total Assets	Total Liabilities and Shareholders Equity

What can a balance sheet tell you?

How efficient is asset utilisation?

How liquid are a company's resources?

Working Capital
Keeping stock down
Minimising debtors

An example Balance Sheet Statement

	Notes	£ million	30 June 2007 £ million	30 June 2006 £ million
Non-current assets				
Intangible assets	11	4,383		4,534
Property, plant and equipment	12	1,932		1,952
Biological assets	13	12		13
Investments in associates	14	1,436		1,341
Other investments	16	128		69
Other receivables	18	17		12
Other financial assets	21	52		42
Deferred tax assets	25	771		1,113
Post employment benefit assets	4	38		14
			8,769	9,090
Current assets				
Inventories	17	2,465		2,386
Trade and other receivables	18	1,759		1,681
Other financial assets	21	78		71
Cash and cash equivalents	19	885		699
			5,187	4,837
Total assets			13,956	13,927
Current liabilities				
Borrowings and bank overdrafts	20	(1,535)		(759)
Other financial liabilities	21	(43)		(36)
Trade and other payables	23	(1,888)		(1,803)
Corporate tax payable	8	(673)		(681)
Provisions	24	(60)		(56)
			(4,199)	(3,335)
Non-current liabilities				
Borrowings	20	(4,132)		(4,001)
Other financial liabilities	21	(104)		(78)
Other payables	23	(38)		(37)
Provisions	24	(274)		(306)
Deferred tax liabilities	25	(582)		(674)
Post employment benefit liabilities	4	(457)		(815)
			(5,587)	(5,911)
Total liabilities			(9,786)	(9,246)
Net assets			4,170	4,681
Equity				
Called up share capital		848		883
Share premium		1,341		1,340
Other reserves		3,186		3,168
Retained deficit		(1,403)		(889)
Equity attributable to equity shareholders of the parent company			3,972	4,502
Minority interests			198	179
Total equity	26		4,170	4,681

3

Cash-Flow Statement

The Statement of Cash Flows provides information about a company's cash payments and cash receipts during an accounting period.

The basis for the Statement of Cash Flows is:
 Cash Flow from Operating Activities + Cash Flow from Investing
 Activities (Free Cash Flow) + Cash Flow from Financing Activities (Net Cash Flow) =
 Net Increase or (Decrease) in Cash

How to relate to a Cash-Flow statement

Company		You
Cash Flows from operating activities		Cash Flows from operating activities
Payment received	Inflow	Salary or tax refund
Employee salaries paid for previous term	Outflow	Utility bills, credit card bills
Payment to a distributor for discount allowances	Outflow	Payment to creche and gardener
Net cash flows from operating activities		Net cash flows from operating activities
Cash Flows from investing activities (Free Cash Flow)		Cash Flows from investing activities (Free Cash Flow)
Profitable sale of assets	Inflow	Profitable sale of property
Purchase of new equipment	Outflow	Purchase of furniture and IT equipment
Net Cash Flows from investing activities		Net Cash Flows from investing activities
Cash Flows from financing activities (Net Cash Flow)		Cash Flows from financing activities (Net Cash Flow)
Loan to finance acquisition	Inflow	Home loan, student loan, vehicle loan
Payment of dividends	Outflow	Acquiring company shares
Net Cash Flows from financing activities		Net Cash Flows from financing activities
Net increase / decrease in cash	Sum of Inflows and Outflows	Net increase / decrease in cash
Cash at the beginning of period		Cash at the beginning of period
Cash at end of period		Cash at end of period

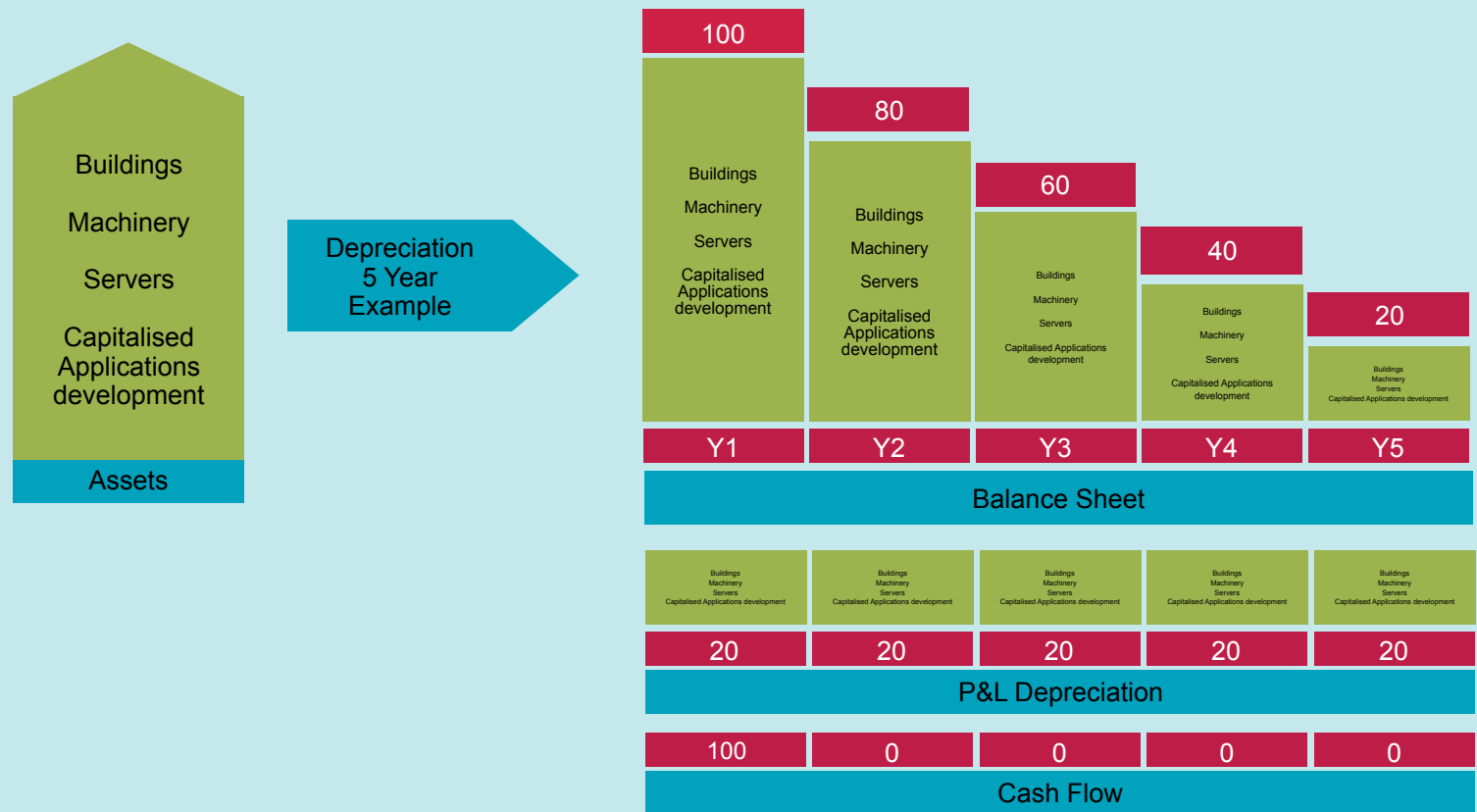
An example Cash Flow Statement

	Notes	Year ended 30 June 2007 £ million	Year ended 30 June 2006 £ million	Year ended 30 June 2005 £ million
Cash flows from operating activities				
Profit for the year		1,556	1,965	1,399
Discontinued operations		(139)	-	(73)
Taxation		678	181	599
Share of associates' profits after tax		(149)	(131)	(121)
Net interest and other net finance income		212	186	141
Losses/(gains) on disposal of businesses		1	(157)	(214)
Depreciation and amortisation		210	214	241
Movements in working capital		(180)	(192)	89
Dividend income and other items	27	83	133	212
Cash generated from operations		2,272	2,199	2,273
Interest received		42	64	146
Interest paid		(279)	(235)	(325)
Dividends paid to equity minority interests		(41)	(40)	(49)
Taxation paid		(368)	(393)	(320)
Net cash from operating activities		1,626	1,595	1,725
Cash flows from investing activities				
Disposal of property, plant and equipment		69	16	18
Purchase of property, plant and equipment		(274)	(257)	(294)
Net (purchase)/disposal of other investments		(6)	7	(6)
Payment into escrow in respect of the UK pension fund		(50)	-	-
Disposal of businesses	28	4	772	1,194
Purchase of businesses	29	(70)	(209)	(258)
Net cash (outflow)/inflow from investing activities		(327)	329	654
Cash flows from financing activities				
Proceeds from issue of share capital		1	3	6
Net purchase of own shares for share schemes		(25)	(32)	(29)
Own shares repurchased		(1,405)	(1,407)	(710)
Net increase/(decrease) in loans		1,226	309	(379)
Redemption of guaranteed preferred securities		-	-	(302)
Equity dividends paid		(858)	(954)	(849)
Net cash used in financing activities		(1,061)	(1,991)	(2,263)
Net increase/(decrease) in net cash and cash equivalents		238	(67)	116
Exchange differences		(50)	(11)	(55)
Net cash and cash equivalents at beginning of the year		651	729	668
Net cash and cash equivalents at end of the year		839	651	729
Net cash and cash equivalents consist of:				
Cash and cash equivalents	19	885	699	787
Bank overdrafts	20	(46)	(48)	(58)
		839	651	729

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Depreciation

Depreciation is the term used to spread the cost of an asset over the span of several years. Take a good look at this diagram. It shows how the purchase of a selection of assets in year 1 is shown in the Cash Flow as a total outflow in the year, but impacts the Balance Sheet and P&L gradually over the chosen depreciation period - In this example 5 years. It is done this way to demonstrate that a purchased asset is still of value to the business over its projected useful life.



Depreciation Exercise

Congratulations you've just finished the first year of running your new Taxi business! It's meant that you've drawn on a lot of your savings and purchased everything you needed including some large purchases (set out below).

Car
£45,000

Satellite
Navigation
£150

Security
Camera
£670

The Meter
£670

Signage
£535

Fuel
£8,000

Decide:

Which of these items you would capitalise and depreciate.
What period you choose to depreciate your assets.

Calculate:

The impact on your P&L each year
over your chosen depreciation period.

Use this space to capture your workings and answer:



We have not provided a standard answer as there are lots of correct ways of completing this exercise depending on the decisions you make. Once you've completed it find someone with some with finance experience who can check your working, and give you even more insight. It will also be helpful to take the opportunity of building your relationships with your organisations finance professionals.