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EBU5402 Enterprise Management

Lecture 9 - Financial Management and Financial
Accounting

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Agenda

- ▶ What is financial management?
- ▶ What is accounting?
 - ▶ Financial Accounting

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Learning Objectives

- ▶ To become **intelligent** users of accounting information
- ▶ Be comfortable looking through an **annual report**
- ▶ Begin to develop the ability to use financial information to **assess** a company's **performance**
- ▶ Have a sense of the **limitations** of financial statement data

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What our objectives are not

- ▶ To train you to be an accountant or bookkeeper
- ▶ To do financial statement analysis

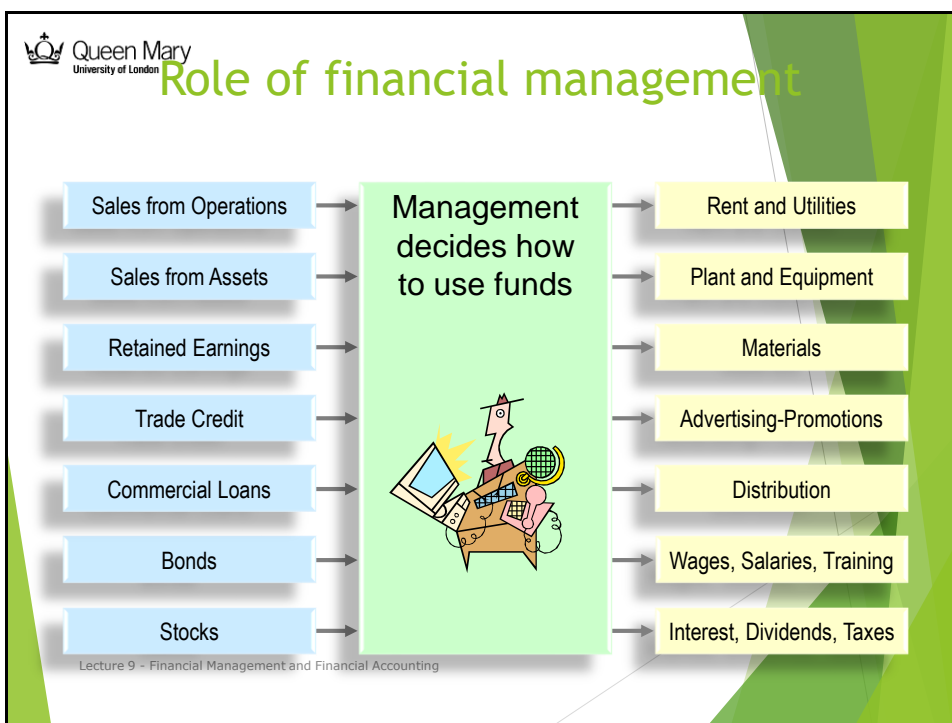
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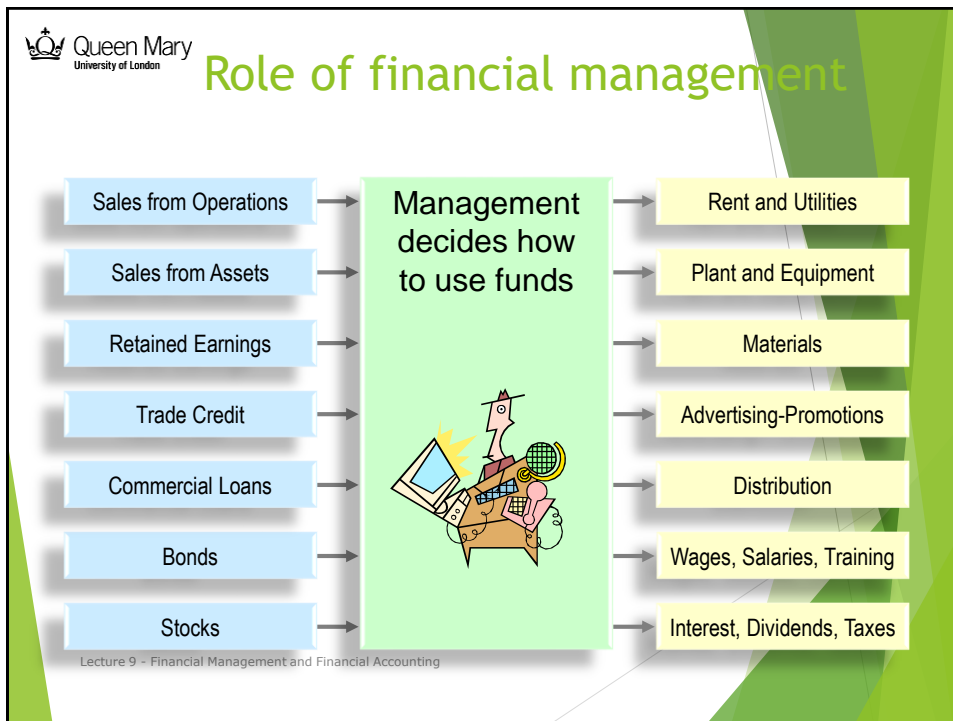



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What is financial management?

Financial management involves making decisions about alternative **sources** and **uses** of funds, with the goal of **maximising** a company's **value**






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Financial Managers

Financial managers:


- develop and implement a firm's financial **plan**
- monitor a firm's **cash flow** and decide how to create or use excess funds
- **budget** for current and future expenditures and for capital investments
- raise **capital** to finance the enterprise for future growth
- **interact** with banks and capital markets

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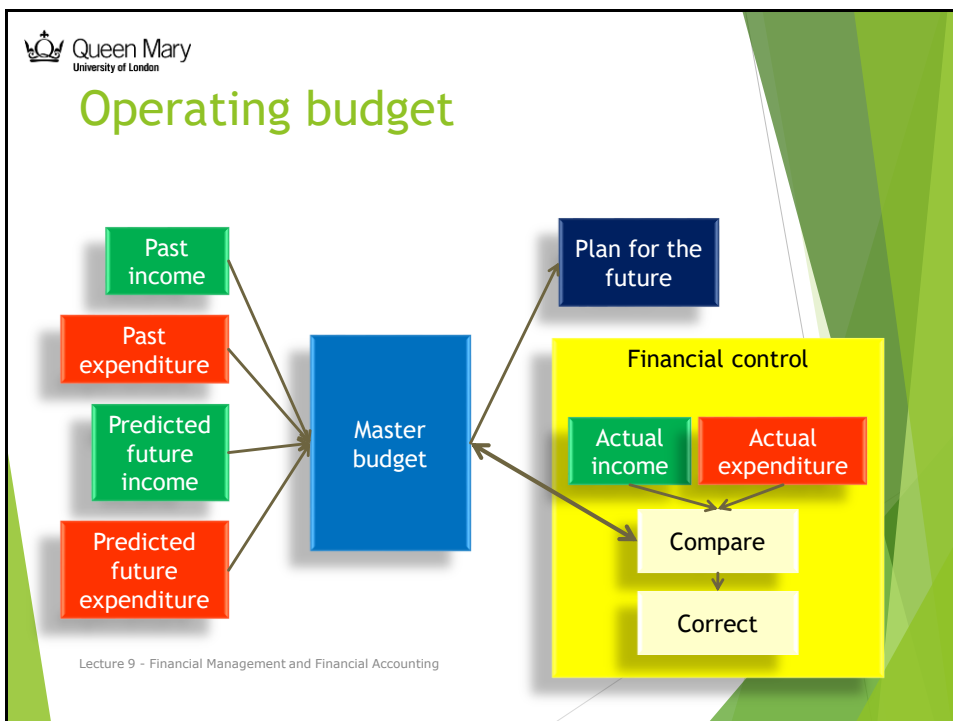
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Operating budget

- ▶ Financial managers develop a financial blueprint for a given period (the **budget**)
- ▶ Budgets help financial managers estimate the **flow** of money into and out of the business
- ▶ The budget sets a **standard** for expenditures, provides **guidelines** for controlling costs, and offers a **plan** for the future
- ▶ Once a budget is in place, the finance manager compares the **actual results** with the budget to discover variances and recommends corrective action—a process known as **financial control**
- ▶ Companies periodically **adjust** their budgets to meet changing financial needs and goals

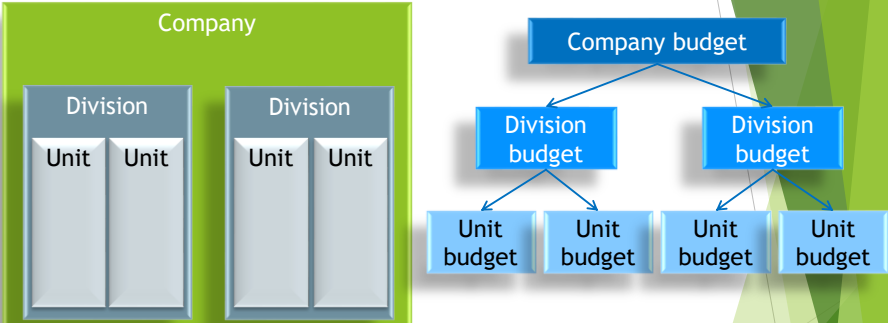


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The hierarchy of budgets



- The Company budget is broken down into Division budgets
- These are broken down into Unit budgets
- Each part of the company is responsible for managing its financial behaviour within its budget

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Financing operations and growth

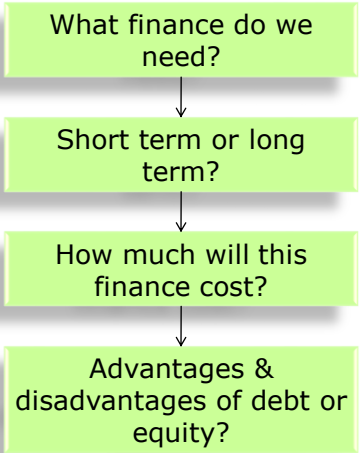
- ▶ Most companies can't **operate** and **grow** without a periodic **infusion** of money
- ▶ Firms need money
 - ▶ to cover the **day-to-day** expenses of running a business, such as paying employees and purchasing supplies
 - ▶ to acquire **new assets** such as land, production facilities, and equipment
- ▶ **Start-up** companies need money to cover the costs involved in launching a new business
- ▶ Some of this money may come from **revenues** (e.g. sales) but some may need to come from **other sources**



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Financing operations and growth - the process



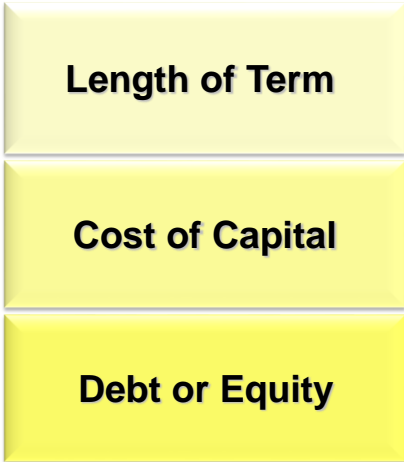
```
graph TD; A[What finance do we need?] --> B[Short term or long term?]; B --> C[How much will this finance cost?]; C --> D[Advantages & disadvantages of debt or equity?];
```

Many sources of long-term and short-term financing exist; each with their own special attributes, risks, and costs


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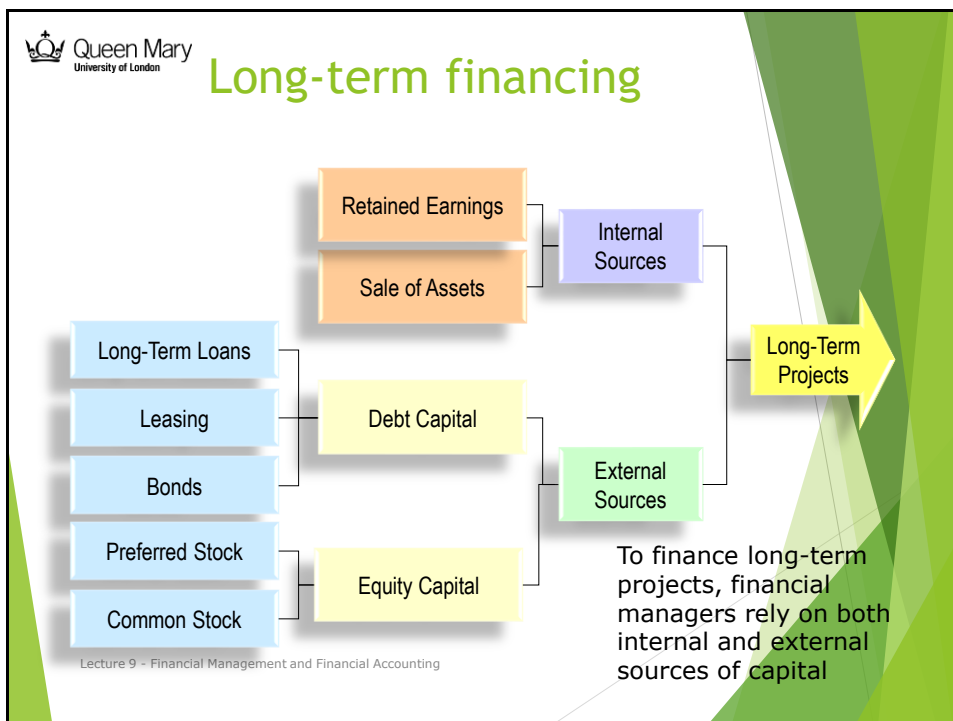
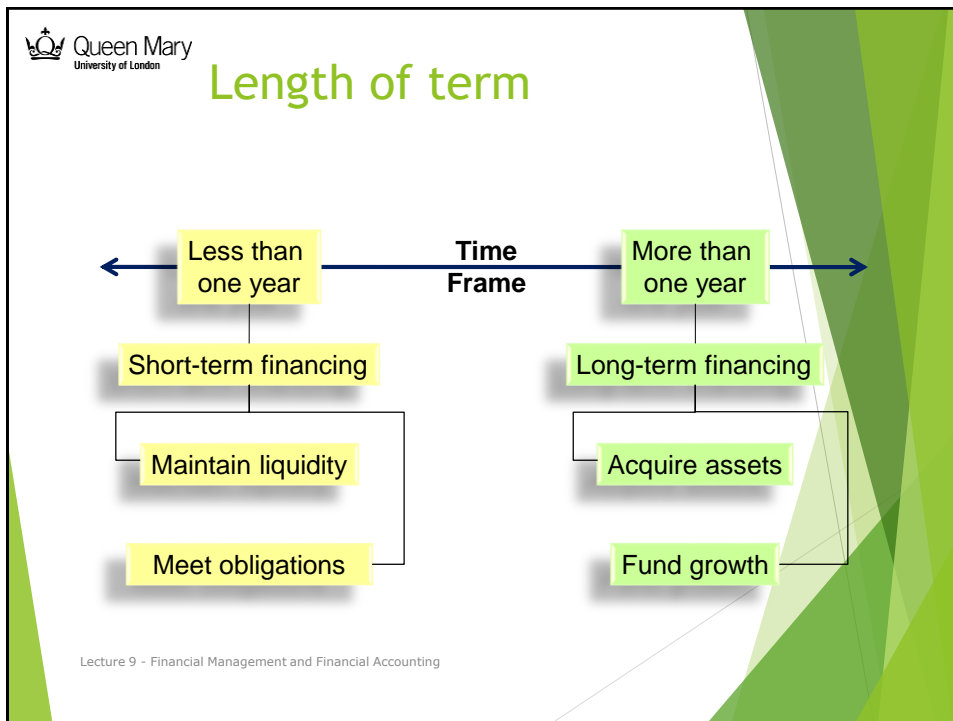
Financing operations and growth - the factors



```
graph TD; A[Length of Term] --- B[Cost of Capital] --- C[Debt or Equity];
```



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1) Recap of key points

- ▶ **Financial management** involves making decisions about alternative **sources** and **uses** of funds, with the goal of **maximising** a company's **value**
- ▶ Financial managers:
 - develop and implement a firm's financial **plan**
 - monitor a firm's **cash flow** and decide how to create or use excess funds
 - **budget** for current and future expenditures and for capital investments
 - raise **capital** to finance the enterprise for future growth
 - **interact** with banks and capital markets

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What is accounting?




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What is accounting?

- ▶ “Accounting is a service provided for those who need **information** about an organisation’s **financial performance**, its **assets** and **liabilities**” [1]




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What is accounting? (cont.)

- ▶ **Profit & Loss Account**
 - ▶ “Shows the measurement of the financial performance of an organisation over a period of time by matching what **sales** and other **incomes** the organisation has made against what it **cost** to make them” [1]
- ▶ **Balance Sheet**
 - ▶ Shows the **assets**, i.e. the possessions and property that an organisation owns
 - ▶ **Liabilities**, i.e. what the organisation owes to other parties, are also shown on the Balance Sheet




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What is accounting? (cont.)

- ▶ What do these financial statements tell you? [2]
 - ▶ How much an organisation owes - **accounts owing**
 - ▶ How much an organisation is owed - **its debts owed**
 - ▶ How well a company has **performed** over a specific time period
- ▶ This information can help the manager to make more effective decisions in the future

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Why do you need to know?

- ▶ Why do non-accountants need to know?
 - ▶ Accounting information is usually used as a **language** that all managers of a business can understand, irrespective of their role (technical, HR etc.)
 - ▶ By using accounting, discussion can take place about the **financial status** of an organisation and **plans for the future** without each functional manager needing to understand all of the activities or terminology of the other functions

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Why do you need to know?

- ▶ In discussions like these, managers will be given information that will help them in 3 areas [3]:
 - ▶ Planning
 - ▶ Control
 - ▶ Decision making



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Why do you need to know?

- ▶ So that you can take an **active** part in discussions about these three areas, you must have a **working knowledge** of the accounting information you are given
- ▶ Depending on the type of organisation you work for, and the position you hold, there may also be **legal requirements** about your compliance with accounting practices e.g. if you are a company director




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Who uses accounting information?

- ▶ A wide range of people use accounting information about an organisation
 - ▶ Investors
 - ▶ Lenders
 - ▶ Employees
 - ▶ Suppliers and other trade creditors
 - ▶ Governments and their agencies
 - ▶ Public
 - ▶ Customers




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Accounting rules [4]

- ▶ There are rules of accounting that are necessary for **consistency** and **understanding** across the industry
- ▶ **Boundary rules**
 - ▶ **Entity** - accounting data must be restricted to the entity itself.

The data should **exclude** the **private** affairs of those individuals who either own or manage the entity, except in so far as they impact directly on it (e.g. cash inputs and withdrawals)







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Accounting rules - boundary rules(cont.)

- ▶ **Periodicity** - accounts should be prepared at the end of a **defined period** of time, and this period should be adopted as the **regular** period of accounts.
This is usually, month-end, end of quarter, year-end
- ▶ **Going concern** - the accounts should be prepared on the assumption that the entity will **continue** in existence for the foreseeable future
- ▶ **Quantitative** - only data that are capable of being easily quantified should be included in an accounting system









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Accounting Rules (cont.)

- ▶ **Measurement rules**
 - ▶ **Historic cost** - financial data should be recorded in the books of account at their historic cost
 - ▶ that is, at their *original purchase cost* or at their *original selling price*
 - ▶ **Dual aspect** - all transactions should be recorded in such a way that they capture the **giving** and the **receiving** effect of each transaction





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What is accounting trying to do?

- ▶ There are two **types** of accounting that are designed to supply information to two different groups of **people**
- ▶ **Financial Accounting**
 - ▶ Provides information primarily to people **outside** the company
 - ▶ Provides information that would be helpful in attracting capital
- ▶ **Management Accounting**
 - ▶ Provides information primarily to people **inside** the company
 - ▶ Internal decision-making
 - ▶ Performance evaluation



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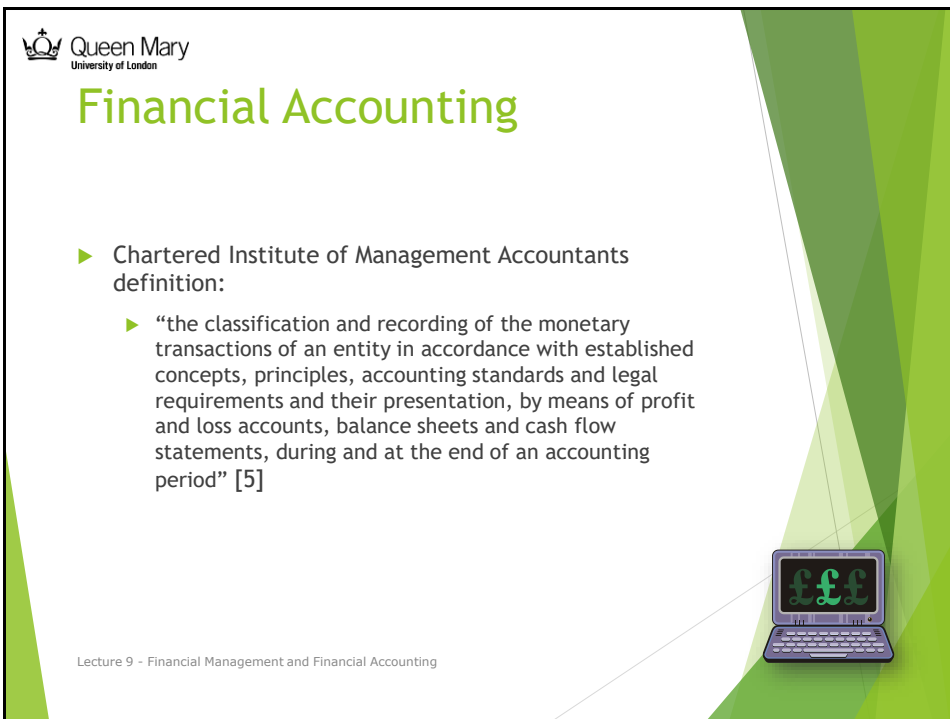
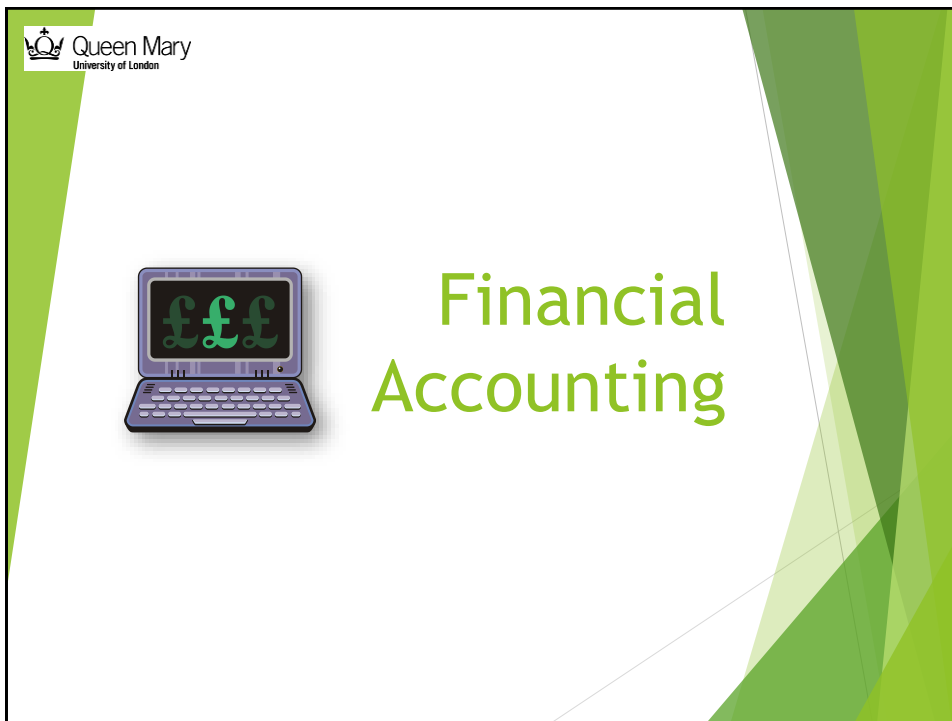


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2) Recap of key points

- ▶ Accounting is a service provided for those who need **information** about an organisation's **financial performance**, its **assets** and **liabilities**
 - ▶ **Profit & Loss Account** shows the measurement of the financial performance of an organisation over, namely **sales**, **incomes**, and **cost**
 - ▶ **Balance Sheet** shows the **assets** and **liabilities**
- ▶ There are rules of accounting that are necessary for **consistency** and **understanding** across the industry
- ▶ Two **types** of accounting that are designed to supply information to two different groups of **people**
 - ▶ **Financial Accounting**
 - ▶ **Management Accounting**

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Financial Accounting

- ▶ Chartered Institute of Management Accountants definition:
 - ▶ “the classification and recording of the monetary transactions of an entity in accordance with established concepts, principles, accounting standards and legal requirements and their presentation, by means of profit and loss accounts, balance sheets and cash flow statements, during and at the end of an accounting period” [5]

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A purple laptop with three green pound symbols (£££) on its screen is positioned in the bottom right corner. The slide features a green geometric background on the right side.




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Financial accounting - key terms

- ▶ **Assets**
 - ▶ “Assets are possessions or resources **owned** by an entity. These include **physical** or **tangible** possessions such as property, plant, machinery, stock and cash, and bank balances. They also might include **intangible** assets, i.e. non-physical possessions such as copyright and patent rights, as well as accounts receivable (debts owed to the entity, i.e. trade and other debtors)” [6]





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Financial accounting - key terms

- ▶ **Capital**
 - ▶ “is the term used to describe the amount which the owners have **invested** in an entity. In effect, their ‘capital’ is the amount owed by the entity to its owners” [7]
- ▶ **Liabilities**
 - ▶ “are the **opposite** of assets. They are the amounts/services **owed** by an entity to outside parties. They include loans, bank overdrafts, accounts payables (amounts owing to parties for the supply of goods and services to the entity that have not yet been settled in cash)” [7]




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Financial accounting - key terms

- ▶ **Stockholders' equity**
 - ▶ Initial investment by the owners (**capital stock - common and preferred stocks**) plus the sum of undistributed profits (**retained earnings**)



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Financial Statements



- ▶ **Balance Sheet**
 - ▶ Assets, liabilities & owner's equity
- ▶ **Income Statement (P&L)**
 - ▶ $\text{Revenue} - \text{Expenses} = \text{Net Income}$
- ▶ **Statement of retained earnings**
 - ▶ Cumulative sum of undistributed profit
- ▶ **Statement of cash flows**
 - ▶ Operating, investing and financing activities


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Financial accounting - double-entry book keeping

- ▶ The first stage of accounting
- ▶ The concept is that every transaction has a **two-fold** effect
- ▶ **Every** transaction must be recorded twice
- ▶ Example -
 - ▶ I lend you £100; there is a two-fold effect
 - 1) I **give** you money, 2) you **receive** money
 - ▶ The effect on **you** is also two-fold: your cash goes up by £100, your **debts** go up by £100
 - ▶ The effect on **me** is two-fold: my cash goes down my £100, what I am owed goes up by £100




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Financial accounting - accounting equation



- ▶ **Accounting equation**
$$\text{Assets} = \text{Capital and Liabilities}$$
- ▶ **Key points [8]**
 - ▶ If an adjustment is made to one side of the equation, you **must** make an identical adjustment **either** to the other side of the equation **or** to the same side
 - ▶ The account that **receives** the transaction is the one that is **debited**; the account that has **given** this amount is the one that is **credited**
 - ▶ This is the **opposite** way round to the way we use the terms 'debit' and 'credit' in everyday life


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Accounts - Trial Balance

- ▶ **Trial Balance**
 - ▶ A statement compiled at the end of a specific accounting period
 - ▶ Usually the source of data for the **Profit & Loss** and **Balance Sheet**

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Trial balance example


Bob's trial balance as at 30th June 2005

	Dr	Cr
	£	£
Bank	5,000	
Capital (as at 1 July 2004)		11,000
Cash	1,000	
Drawings	8,000	
Motor vehicle at cost	6,000	
Motor vehicle expenses	2,000	
Office expenses	3,000	
Purchases	30,000	
Trade creditors		4,000
Trade debtors	10,000	
Sales		50,000
	65,000	65,000

[9] Lec

These should always be equal – because what you spent came from somewhere, if not cash then credit




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Accounts

- Profit & Loss Account [10]

- ▶ **Profit and Loss Account**, also known as 'Income Statement'
- ▶ Measures the 'performance' of a company *over a period of time*
- ▶ Data taken from the Trial Balance
- ▶ **Gross profit figure** is
 - ▶ gross profit = sales revenue - cost of goods sold
- ▶ This figure is entered into the Profit & Loss account
- ▶ The next stage is:
 - ▶ gross profit + revenue income - revenue expenditure = net profit (or net loss)


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Terms


- ▶ **Revenues**
 - ▶ A measure of economic **benefits** generated by the sales of products or provision of services *over a period of time*
- ▶ **Expenses**
 - ▶ A measure of economic **sacrifices** incurred to 'earn' the revenue of a *given period*



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Trial balance example



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	65,000	65,000

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Profit & Loss account example

Bob's profit & loss account for the year to 30 June 2005


	£	£
Sales (as at 1 July 2005)		50,000
Less: cost of goods sold		
Purchases		
Gross profit		
Less: expenses		
Motor vehicle expenses		
Office expenses		
Net profit for the year		

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Trial Balance example



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Profit & Loss account example


Bob's profit & loss account for the year to 30 June 2005

	£	£
Sales (as at 1 July 2005)		50,000
Less: cost of goods sold		
Purchases		30,000
Gross profit		20,000
Less: expenses		
Motor vehicle expenses		
Office expenses		
Net profit for the year		


gives a gross profit of



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Trial Balance example



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	65,000	65,000

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Profit & Loss account example

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	£	£
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Purchases		30,000
Gross profit		20,000
Less: expenses		
Motor vehicle expenses	2,000	
Office expenses		
Net profit for the year		

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Trial Balance example



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Sales		50,000
	65,000	65,000

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Profit & loss account example


Bob's profit & loss account for the year to 30 June 2005

	£	£
Sales (as at 1 July 2005)		50,000
Less: cost of goods sold		
Purchases		30,000
Gross profit		20,000
Less: expenses		
Motor vehicle expenses	2,000	
Office expenses	3,000	5,000
Net profit for the year		15,000

gives a net profit of


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Accounts - Balance Sheet [12]


- ▶ The Balance Sheet gives:
 - ▶ a statement of the **financial position** of a business as of a **certain date**
 - ▶ a list of all the **capital revenue** and **capital expenditure** balances
- ▶ $ASSETS = LIABILITIES + SHAREHOLDERS' EQUITY$



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Trial Balance example




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	65,000	65,000

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Balance Sheet example




Bob's balance sheet as at 30th June 2005

	£	£
<i>Fixed assets</i>		
Motor vehicle at cost		6,000
<i>Current assets</i>		
Trade debtors		
Bank		
Cash		
<i>Current liabilities</i>		
Trade creditors		
<i>Capital</i>		
Balance as at 1 July 2004		
Add: net profit for the year		
Less: drawings		

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Trial Balance example




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Balance sheet example




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	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank		
Cash		
<i>Current liabilities</i>		
Trade creditors		
<i>Capital</i>		
Balance as at 1 July 2004		
Add: net profit for the year		
Less: drawings		

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Trial balance example




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Balance Sheet example




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	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash		
<i>Current liabilities</i>		
Trade creditors		
<i>Capital</i>		
Balance as at 1 July 2004		
Add: net profit for the year		
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Trial Balance example




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	65,000	65,000

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Balance sheet example




Bob's balance sheet as at 30th June 2005


	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash	1,000	
	16,000	
<i>Current liabilities</i>		
Trade creditors		
<i>Capital</i>		
Balance as at 1 July 2004		
Add: net profit for the year		
Less: drawings		

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gives total current assets of

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Trial Balance example



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 **Balance Sheet example** 

Bob's Balance Sheet as at 30th June 2005

	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash	1,000	
	<u>16,000</u>	
<i>Current liabilities</i>		
Trade creditors	4,000	12,000
		<u>18,000</u>
<i>Capital</i>		
Balance as at 1 July 2004		
Add: net profit for the year		
Less: drawings		

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current assets
less current
liabilities

 **Trial Balance example** 


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Balance sheet example



Bob's balance sheet as at 30th June 2005

	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash	1,000	
	16,000	
<i>Current liabilities</i>		
Trade creditors	4,000	12,000
		18,000
<i>Capital</i>		
Balance as at 1 July 2004		11,000
Add: net profit for the year		
Less: drawings		
		i.e. at start of year

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Profit & loss account example

Bob's profit & loss account for the year to 30 June 2005


	£	£
Sales (as at 1 July 2005)		50,000
Less: cost of goods sold		
Purchases		30,000
<i>Gross profit</i>		20,000
Less: expenses		
Motor vehicle expenses	2,000	
Office expenses	3,000	5,000
Net profit for the year		15,000

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Balance sheet example




Bob's balance sheet as at 30th June 2005

	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash	1,000	
	<u>16,000</u>	
<i>Current liabilities</i>		
Trade creditors	4,000	<u>12,000</u>
		<u>18,000</u>
<i>Capital</i>		
Balance as at 1 July 2004		11,000
Add: net profit for the year	15,000	
Less: drawings		
		<u>11,000</u>

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Trial Balance example




Bob's trial balance as at 30th June 2005

	Dr	Cr
	£	£
Bank	5,000	
Capital (as at 1 July 2004)		11,000
Cash	1,000	
Drawings	8,000	
Motor vehicle at cost	6,000	
Motor vehicle expenses	2,000	
Office expenses	3,000	
Purchases	30,000	
Trade creditors		4,000
Trade debtors	10,000	
Sales		50,000
	<u>65,000</u>	<u>65,000</u>

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Balance sheet example



Bob's balance sheet as at 30th June 2005

	£	£
<i>Fixed assets</i>		
Motor vehicles at cost		6,000
<i>Current assets</i>		
Trade debtors	10,000	
Bank	5,000	
Cash	1,000	
	<u>16,000</u>	
<i>Current liabilities</i>		
Trade creditors	4,000	<u>12,000</u>
		18,000
<i>Capital</i>		
Balance as at 1 July 2004		11,000
Add: net profit for the year	15,000	
Less: drawings	<u>8,000</u>	<u>7,000</u>
		18,000


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In-Class Exercise 1


- ▶ Go through the exercise in groups
- ▶ Consider individually and discuss your answers in groups

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In-Class Exercise 1



Exercise - from this Trial Balance create the P&L account and Balance Sheets


	Dr £000	Cr £000
Bank	4	
Buildings	50	
Capital		50
Cash	2	
Creditors		24
Debtors	30	
Drawings	55	
Heat and light	10	
Miscellaneous expenses	25	
Purchases	200	
Sales		400
Wages and salaries	98	
	474	474

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Cash flow statements [17]

- ▶ The **cash flow statement** (CFS) is now considered to be one of the main financial statements alongside the Profit & Loss and Balance sheets
- ▶ The statement of cash flows is useful in determining the **short-term viability** of a company, particularly its ability to pay bills
- ▶ It lists all the **cash receipts** and all the **cash payments** during the preparation of a CFS during a particular period
- ▶ Remember that even a **profit making** organisation can still be **cash poor** as they may not immediately receive payments for sales etc
- ▶ As a manager you need to monitor cash flow



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P&L used to generate Cash Flow Statement

Flowers profit & loss account for the year to 31st December 2006

	£000	£000
Sales		1000
Less: Cost of goods sold		
Opening stock	200	
Purchases	700	
	<u>900</u>	
Less: closing stock	<u>300</u>	<u>600</u>
Gross profit		400
Operating expenses		<u>(240)</u>
Operating profit		160
Debenture interest		<u>(10)</u>
Net profit before taxation		150
Taxation		<u>(50)</u>
Net profit after taxation		100
Dividends		<u>(60)</u>
Retained profit for year		40

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
<i>Current assets</i>				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
	<u>340</u>		<u>495</u>	
<i>Less: current liabilities</i>				
Trade creditors	70		90	
Taxation	40		50	
Proposed dividend	30		60	
	<u>140</u>	200	<u>200</u>	295
		<u>950</u>		<u>1090</u>

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P&L used to generate Cash Flow Statement

Flowers profit & loss account for the year to 31st December 2006

	£000	£000
Sales		1000
Less: Cost of goods sold		
Opening stock	200	
Purchases	700	
	900	
Less: closing stock	300	600
Gross profit		400
Operating expenses		(240)
Operating profit		160
Debenture interest		(10)
Net profit before taxation		150
Taxation		(50)
Net profit after taxation		100
Dividends		(60)
Retained profit for year		40

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	
Returns on investment and servicing of finance	
Interest paid	
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
	155
Reconciliation of operating profit to net cash inflow from operating activities	
Operating profit	160
Depreciation	
(Increase) in stocks	
(Increase) in trade debtors	
Increase in trade creditors	
Net cash inflow from operating activities	155

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
<i>Current assets</i>				
Stocks	200		300	
Trade debtors				
Cash				
<i>Less: current liabilities</i>				
Trade creditors				
Taxation	40		50	
Proposed dividend	30		60	
	140	200	200	295
		950		1090

change in accumulated depreciation is $255 - 150 = 105$

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	
Returns on investment and servicing of finance	
Interest paid	
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
Operating profit	160
Depreciation	105
(Increase) in stocks	
(Increase) in trade debtors	
Increase in trade creditors	
Net cash inflow from operating activities	

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
<i>Current assets</i>				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
	340		495	
<i>Less: current liabilities</i>				
Trade creditors	70		80	
Taxation				
Proposed dividend				
	140	200	200	295
		950		1090

increase in stocks is $300 - 200 = 100$

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

Net cash inflow from operating activities	£k
Returns on investment and servicing of finance	
Interest paid	
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
Operating profit	£k 160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	
Increase in trade creditors	
Net cash inflow from operating activities	155

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
Current assets				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
	340		495	
Less: current liabilities				
Trade creditors				
Taxation				
Proposed dividend				
	140	200	200	295
		950		1090

change in trade debtors
is
 $150 - 120 = 30$

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	
Returns on investment and servicing of finance	
Interest paid	
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	
Net cash inflow from operating activities	

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
Current assets				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
	340		495	
Less: current liabilities				
Trade creditors	70		90	
Taxation	40		50	
Proposed dividend	30		60	
			295	
			1090	

change in trade creditors is $90 - 70 = 20$

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	155
Returns on investment and servicing of finance	
Interest paid	
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155

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P&L used to generate Cash Flow Statement

Flowers profit & loss account for the year to 31st December 2006

	£000	£000
Sales		1000
Less: Cost of goods sold		
Opening stock	200	
Purchases	700	
	900	
Less: closing stock	300	600
Gross profit		400
Operating expenses		(240)
Operating profit		160
Debenture interest		(10)
Net profit before taxation		150
Taxation		(50)
Net profit after taxation		100
Dividends		(60)
Retained profit for year		40

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	155
Returns on investment and servicing of finance	
Interest paid	(10)
Taxation	
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
	£k
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
Current assets				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
Less: current liabilities				
Trade creditors		70		90
Taxation		40		50
Proposed dividend		30		60
	140	200	200	295
		950		1090

tax is paid in the following year

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	155
Returns on investment and servicing of finance	
Interest paid	(10)
Taxation	(40)
Capital expenditure	
Payments to acquire fixed tangible assets	
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
	£k
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
Current assets				
Stocks	200		300	
Trade debtors	120		150	
Cash				
Less: current liabilities				
Trade creditors	70		90	
Taxation	40		50	
Proposed dividend	30		60	
	140	200	200	295
		950		1090

payments to acquire tangible fixed assets
 $1050 - 900 = 150$

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	155
Returns on investment and servicing of finance	
Interest paid	(10)
Taxation	(40)
Capital expenditure	
Payments to acquire fixed tangible assets	(150)
Equity dividends paid	
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
	£k
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155

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Balance Sheet used to generate Cash Flow Statement

Flowers balance sheet as at 31st December 2006

	2005		2006	
	£000	£000	£000	£000
Fixed assets at cost	900		1050	
Less: accumulated depreciation	150	750	255	795
Current assets				
Stocks	200		300	
Trade debtors	120		150	
Cash	20		45	
	340		495	
Less: current liabilities				
Trade creditors	70		90	
Taxation	40		50	
Proposed dividend	30		60	
	140	200	200	295
		950		1090

dividends are paid in the following year

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FRS1)

	£k
Net cash inflow from operating activities	155
Returns on investment and servicing of finance	
Interest paid	(10)
Taxation	(40)
Capital expenditure	
Payments to acquire fixed tangible assets	(150)
Equity dividends paid	(30)
	(75)
Management of liquid resources and financing	
Issue of debenture stock	
Increase in cash	
Reconciliation of operating profit to net cash inflow from operating activities	
	£k
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155

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Cash flow statement for P&L/Balance Sheet

Flowers cash flow statement as at 31st December 2006 (to FR51)

Flowers had negative cash flow (i.e. more went out than came in) and should have perhaps considered issuing some debenture stock to raise money

	£k
Net cash inflow from operating activities	155
Investment in property, plant and equipment	(10)
Acquisition of subsidiaries	(40)
Dividends received	(150)
Equity dividends paid	(30)
	(75)
Management of liquid resources and financing	
Issue of debenture stock	0
Increase in cash	(75)
Reconciliation of operating profit to net cash inflow from operating activities	
	£k
Operating profit	160
Depreciation	105
(Increase) in stocks	(100)
(Increase) in trade debtors	(30)
Increase in trade creditors	20
Net cash inflow from operating activities	155


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In-Class Exercise 2


- ▶ Go through the exercise in groups
- ▶ Consider individually and discuss your answers in groups

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In-Class Exercise 2




Petals balance sheet as at 31st January 2007

	31st January 2006		31st January 2007	
	£000	£000	£000	£000
<i>Fixed assets</i>				
Land at cost		600		700
<i>Current assets</i>				
Stock	100		120	
Debtors	200		250	
Cash	6		10	
	<u>306</u>		<u>380</u>	
<i>Less current liabilities</i>				
Creditors	<u>180</u>	<u>126</u>	<u>220</u>	<u>160</u>
		<u>726</u>		<u>860</u>
<i>Capital and reserves</i>				
Ordinary share capital		700		800
Profit and loss account		<u>26</u>		<u>60</u>
		<u>726</u>		<u>860</u>

Exercise - from this Balance Sheet create the cash-flow statement


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3) Recap of key points

- ▶ **Balance Sheet**
 - ▶ a statement of the **financial position** of a business as of a **certain date**
 - ▶ Assets, liabilities & owner's equity
- ▶ **Profit and Loss Account (Income Statement)**
 - ▶ measures the 'performance' of a company *over a period of time*
 - ▶ Revenue - Expenses = Net Income
- ▶ **Cash Flow Statement**
 - ▶ a statement of cash flows is useful in determining the **short-term viability** of a company, particularly its ability to pay bills
 - ▶ It lists all the **cash receipts** and all the **cash payments** during the preparation of a CFS during a particular period

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Directed Reading

Course Textbook (Ebert, R. J. and Griffin, R. W., 9th Edition)


- ▶ Chapter 14. The Role of Accountants and Accounting Information (p356 - p378)

Additional Reading

- ▶ Dyson, J. R. (2007), *Accounting for non-accounting Students*, 7th edition, Times/ Prentice Hall; ISBN-10: 0273709224/ISBN-13: 978-0273709220




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11. .. Pg. 86	22. .. Pg. 214
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