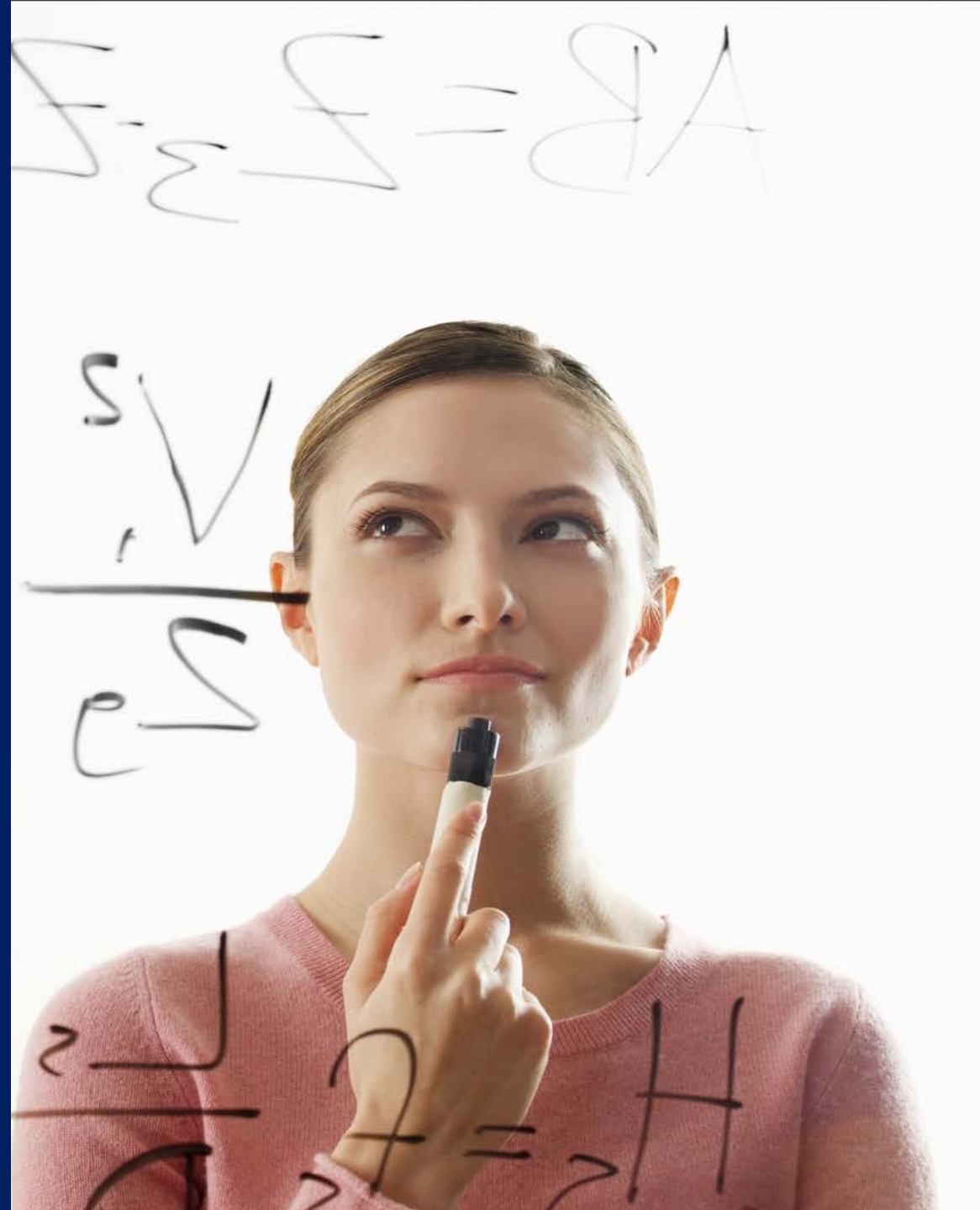




Reading and Interpreting Accounts

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Reading and Interpreting Accounts

Disclaimer

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Agenda

-  Elements of Financial Statements
-  Case study 1
-  Users of financial statements
-  Case study 2
-  Wrap up

What Will You Learn

- Elements of Financial Statements
- Is Working Capital a Going Concern Issue?
- Interpretation by users of Financial Statements.
- Analyse some key financial performance measures.





Elements of Financial Statements



Complete Set of Financial Statements

Consists of the following:

- Statement of financial position
- Statement of profit or loss and other comprehensive income or Statement of Income and Retained earnings
- Statement of changes in equity
- Statement of cash flows
- Notes – Significant accounting policies and other explanatory information
- Comparative information



Case Study 1



Statement of financial position

- **Financial services entity**
- **Listed on stock exchange**
- **Discuss in your groups (20 minutes):**
 - What is the key difference between the two statements
 - What are the key advantage and disadvantage of the two presentations
 - How would you deal with the disadvantages by referring to other information in the financial statements?

Main reason for this exercise is that entities listed on SPSE can have either presentation and hence as users it is important to understand how to compare and read the two types of presentation.

Case Study 1 - Debrief

Debrief

- What is the key difference between the two statements?
Liquidity vs Current/Non-current presentation
- What is the key advantage and disadvantage of the two presentations?
Advantage: Presentations are aligned to nature of business, for liquidity long term assets and short term liabilities.
Disadvantage: Working capital deficiency not shown on face of the statement under the liquidity presentation.
- How would you deal with the disadvantage by referring to other information in the financial statements?
 - 1) Working capital deficiency on it's own does not necessarily warrant a Going Concern issue. Look for Going Concern matters raised in the auditor report or basis of preparation notes.
 - 2) Risk management notes – Liquidity notes on contractual maturities of financial liabilities. Financial assets can be included in the maturity analysis if certain criteria met.



Users of Financial Statements



Users of financial statements

Common users

- Management, Investors, Shareholders, Regulators, Lenders, Employees, Customers

There are many possible users of financial statements, all having different reasons for wanting access to financial statements information.



Case study 2

Refer to handout provided.

Entity background

- Manufacturing entity
- Key statements and accounting policy notes are provided
- 3 users: Shareholders, Investors and Management
- Certain key financial performance indicators to evaluate

Discuss in your groups based on which user of financial statement you have been allocated the key financial performance measures.

Be ready to present your findings (30 minutes)



Case study 2 - continued

Investor



Profitability (NPAT)
EBITDA
Gross profit margin
Return on Assets

Shareholder



Profitability (NPAT)
Debt to equity ratio
Return on equity ratio
Current ratio

Management



Inventory days
Debtor days
Creditor days
Current ratio
Quick ratio

Case Study 2 - Debrief

Investors:

- **Profitability** – growing
 - Operating cash flow not sufficient for dividend payouts.
 - \$3m still sitting as liabilities from previous period dividends.
 - Decline in sales – need to see if due to price or volume.
- **Return on Assets** – increase is favorable
 - Significant increase in Inventory could mean possibly not realising revenue on time and storage/holding costs.
 - More than 50% of assets is PPE, why? Revaluation! Policy notes.
- **EBITDA** – strong growth
 - Indicates potential for future growth is positive
 - EBITDA is stronger compared to Net Profit due to depreciation charge been the largest component of COS.



Case Study 2 - Debrief

Investors (continued):

- **Gross margin** – strong growth
 - Mainly due to decrease in costs.
 - Sales is constant but increase in debtors and decrease in cash receipts may be of concern.

Shareholders:

- **Profitability** – same as Investors
 - As they both share the same objective of returns in the form of dividends.
- **Debt to equity ratio** – highly debt geared
 - Reduction is mainly by decrease in dividend payables.
 - Borrowings repayments were done but overdraft reliance in 2017.
- **Return on equity** – minimal growth noted
 - Could mean assets not generating enough profitability; or
 - Working capital management issues.



Case Study 2 - Debrief



Shareholders (continued):

- **Current ratio** – favourable
 - Rule of thumb 2:1.
 - However, Inventory is 69% of current assets balance hence current ratio may not be a true reflection of working capital for manufacturing entities.

Management

- **Inventory/Debtor/Creditor days**
 - Individually neither is good.
 - Needs to be looked at collectively as they represent working capital management effectiveness.
 - Creditors are settled much faster compared to inventory sales and debtor collections. Hence cash tied up in debtors and inventory!
 - This could explain why the entity needs overdraft facility.
 - Need to relook at negotiating creditor and debtor terms to match.
 - Also look at production of inventory, e.g. Just-In-Time basis

Case Study 2 - Debrief

Management (continued)

- **Current ratio** – same as Shareholders
- **Quick ratio** - not favourable
 - Shows inability to meet short term liability settlement
 - Hence the reason dividends are largely unpaid and classified as non-current.



Wrap up

- **A set of financial statements depicts a story about an entity.**
- **Apart from the main statements the notes and accounting policies are equally important.**
- **Financial statements are continuously changing with enhanced disclosure requirements.**
- **New IFRS standards 9, 15 and 16 will result in changes.**
- **Listed entities have increased requirements under the Companies Act 2015.**



Action

Substance over form

I encourage you to pick up a set of financial statements available and analyse these to enhance your financial literacy.

Ask for help if you do not understand!





Thank you



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