Financial training for non financial staff

ATTAINMENT TRAINING

The financial training specialists

Company accounts: what are we looking at?

It's often confusing when we pick up a set of published accounts (also called Financial Statements) for an organisation. There's a lot there. What's important? Where do we look? What are we looking for? What's good? What's healthy? What are the warning signs we need to look for?

We'll try and answer all these questions in this section of the Vault, but we'll start off by seeing what's there. All sets of accounts will contain the following elements (or at least, some of them).

The Profit and Loss account (P&L)
This is sometimes called a Statement of Comprehensive Income. It shows the sales and costs of the business, and how profitable it is. Or isn't! It shows whether the business is growing, static or shrinking, and whether it's living within its income.

The Balance Sheet
A list of the assets and liabilities of the business, including (importantly) its cash position and working capital. It helps us see how solvent the business is, and how well it's managing its cashflow. Poor cashflow (rather than poor profitability) is the most common cause of business failure.

The Cashflow Statement
This helps reconcile the profitability and cashflow of the business. It helps us understand how, if the business has made this much profit, why the bank account hasn't grown by the same amount. Not every business includes a Cashflow Statement.

The Accounting policies
Many assumptions go into putting the accounts together. The accounting policies tell us about these assumptions, and it's up to us to assess how reasonable they seem.

Notes to the accounts
We need more information about many of the numbers in the P&L and Balance Sheet, and the notes to the accounts is where we'll find that information.

The Directors' report
This is the Directors' "shop window" where they tell us what they want us to hear about the business. It's useful to hear their message, but we must make sure it's backed up by the numbers, otherwise it's just propaganda.

The auditor's report
This is the third party independent assessment of the accounts. A "clean" unqualified audit report tells us they have found nothing worthy of disclosure, whilst a qualified report tells us

that they have major concerns. But we must never let an unqualified audit report stop us exercising our own assessment of the numbers.

Which of these are most important?
When I'm looking at a company's accounts I always look at the P&L account, and the Balance Sheet. They help me see whether the company is growing or shrinking; whether it's making money or losing money; and whether its cash position is getting better or worse. Those are the key questions we have to be able to answer to assess the business.

To answer these questions I need to look at some of the notes to the accounts, especially those related to current assets, current liabilities and long term liabilities.

That's my irreducible minimum of information. I may glance through the accounting policies, and the rest of the notes to the accounts, but not always. I may check the audit report. I'll less often look at the directors' report.

Abbreviated accounts
Smaller companies can produce abbreviated accounts. We can still get some information from these, but there's a lot we can't get.

Other Vault articles
In the rest of the section on *Analysing the accounts* I'll expand on all the elements we have touched on in this article.