

## Unit 32

### The use of financial documents

#### 1. Using financial documents to assess the performance of a business

##### 1.1 Managers and employees

<u>Parties</u>	<u>Interest</u>
<b>1. Manager</b>	: Manager will want to assess the performance of the company. The profit made by business will be a reflection of their own performance.
<b>2. Employees</b>	: Employees might need financial information during wage negotiations. Information about profit and the prospects of the business could be used to decide whether it can afford to meet a wage claim.
<b>3. Owners</b>	: Owners of small businesses will obviously be interested in the performance and the financial position of the business. ( Position & dividend)
<b>4. Shareholders</b>	: They may look the size of dividends. They may use ratio analysis to see how their investment is performing and make comparisons with other companies in which they could invest.
<b>5. External shareholders</b>	Bankers : Need up-to-date financial information when deciding whether to lend money to a business.  Supplier : Supplier will want to assess the creditworthiness of businesses that buy resources from them using trade credit.

## **2. Using financial documents to inform decision making**

: Businesses will make better-informed decisions if they have access to financial documents.

### **2.1 Funding decisions**

: Access to relevant financial information can help to predict when more money will be needed by a business.

: Eg. If firm is planning to expand it, firms need to analyse the level of non-current liabilities.

### **2.2 Reducing costs**

: A business might use the statement of comprehensive income to analyse costs.

: For example, by comparing the gross profit margin and the operating profit margin over a time period.

### **2.3 Increasing profitability**

: It may be possible to use the accounts to help find ways of making more profit.

: For example, the gross profit margins are small in relation to competitors, it may be because prices are too low or cost of sales is too high.

### **2.4 Investment decisions**

: Investment decisions are risky and uncertain because business can never know for sure whether an investment project will generate returns in the future. The future is very difficult to predict.

### **2.5 Government**

: The government uses the information to monitor the progress of the economy and help evaluate the success of its economic policies. People doing research may also use the information.

## **2.6 Competitors**

: Limited company accounts are available to the public. Therefore, competitors can analyse them to make comparisons.

## **2.7 The media**

: Television, online media companies and radio often produce reports on business and commerce. There are also specialists that focus on business information, for example, the Financial Times newspaper in the UK.

## **2.8 Tax authorities**

: The tax authorities may require details of income when working out how much tax businesses and their owners must pay.

## **2.9 Auditors**

: Every year, the accounts of limited companies have to be checked by an independent firm of accountants and registered auditors. The process of checking the accuracy of accounts is called auditing.

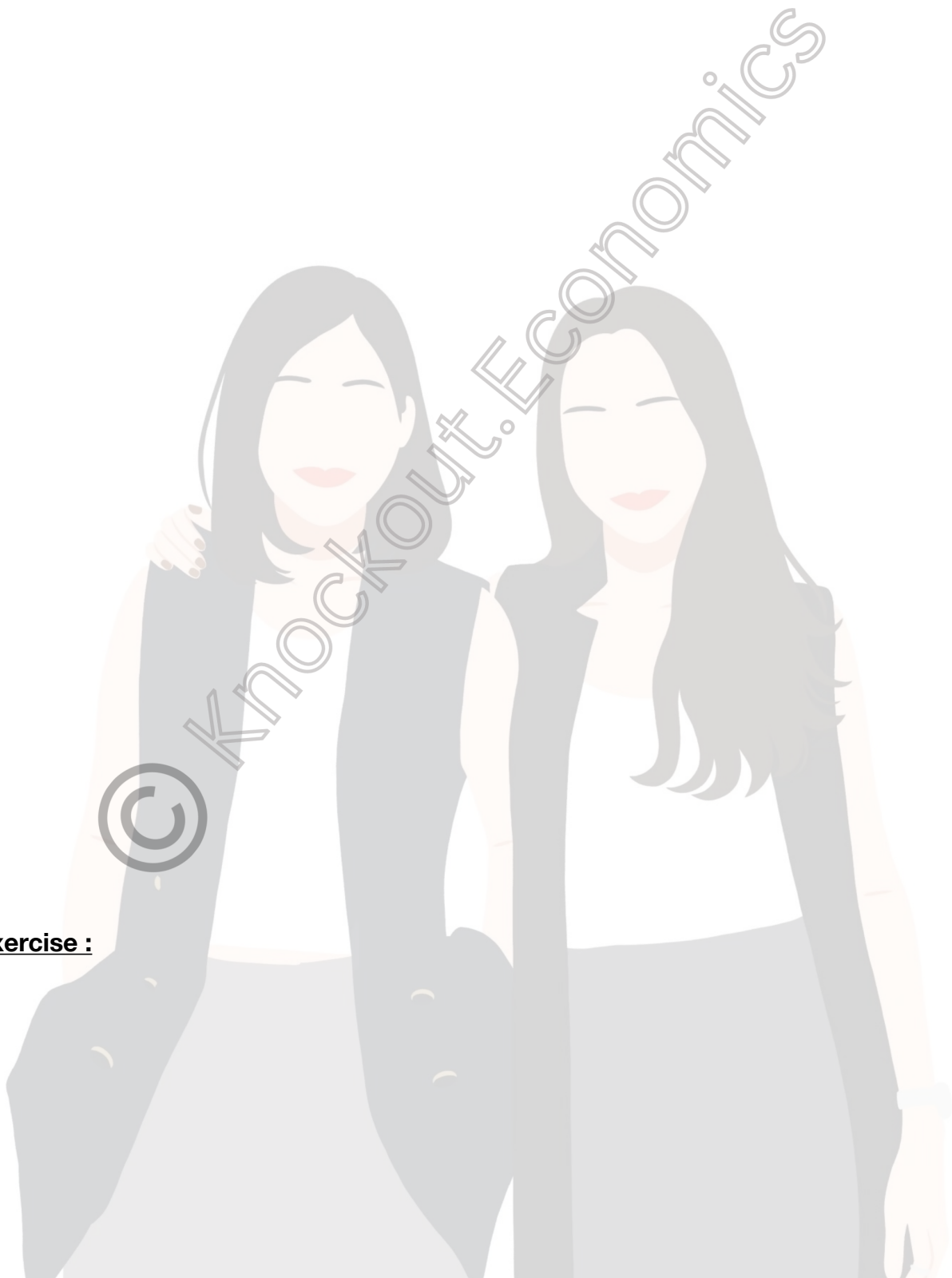
## **2.10 Registrar of companies**

: In many countries, limited companies have to register with a registrar of companies. One of the conditions of registration is that they submit a copy of their financial accounts every years.

Exercise- End of chapter

**MULTIPLE-CHOICE QUESTIONS**

- ▶ 1 The owners of a business may use financial documents to assess a company's?
  - A Current assets
  - B Profitability
  - C Market share
  - D Cash flow position
- ▶ 2 A bank may use a company's financial documents to help assess?
  - A Labour turnover
  - B Growth potential
  - C Creditworthiness
  - D Product quality
- ▶ 3 The authenticity of financial documents is checked by?
  - A Suppliers
  - B Shareholders
  - C Auditors
  - D Local authorities
- ▶ 4 Financial documents might be used to help a business make decisions about which of the following?
  - A Funding
  - B Marketing strategies
  - C Remuneration methods
  - D Effect of changes in exchange rates on the business



**Exercise :**



▲ Swimming pool

► Table 32.5 Varl Town Pools statement of financial position, year ending 31 December 2016

	2016 A\$000	2015 A\$000
<b>Non-current assets</b>	2300	2300
Property	4800	5000
Plant and equipment	7100	7300
<b>Current assets</b>		
Inventories	3800	3000
Trade receivables	4800	4600
Cash	1200	5300
	9800	12900
<b>Current liabilities</b>		
Trade payables	5100	4300
Taxation	100	1600
	5200	5900
<b>Net current assets</b>	4600	7000
<b>Non-current liabilities</b>		
Borrowings	(1900)	(1000)
<b>Net assets</b>	9800	13300
<b>Shareholders' equity</b>		
Share capital	3000	3000
Retained profit	6800	10300
<b>Capital employed</b>	9800	13300

## CHAPTER QUESTIONS

- 1 Describe one reason why employees at Varl Town Pools might be interested in the financial documents shown in the tables above.
- 2 Discuss two ways in which Varl Town Pools might use financial documents to make decisions.
- 3 Assess the performance of Varl Town Pools between 2015 and 2016. Make a clear judgement in your evaluation.



