

Use and Users of Financial Statements

Editorial

This month's feature considers who are the users of the financial information that we as students and members of the ICB prepare.

Although primarily written with the Level 3 Diploma student in mind, this should be of interest to all our student readership.

At the Level 3 Diploma in Bookkeeping the student is expected to develop competence in the preparation of a range of financial statements for varied types of businesses and it is good practice to ask the question "Who are the users of such statements and what are their needs?"

I hope that you find this feature useful in enhancing your continuing professional development.

Regards

Philip Dunn

Editor

Financial Statements their Usefulness and the User

Focus on the usefulness of published financial statements has been at the centre of public debate for more than three decades. In 1975 the **Corporate Report** was published, this was the outcome from the Accounting Standards Steering Committee's wide ranging discussion paper and in part considered the usefulness of financial statements. The Report's conclusion as to the fundamental objective of published accounts included the following statement:

"The fundamental objective of corporate reports is to communicate economic measurements of and information about the resources and performance of the reporting entity useful to those having reasonable rights to such information".

In more recent times the Accounting Standards Board published its *Statement of Principles for Financial Reporting* (Dec 1999) and the concept of usefulness was a significant feature in this publication. Also the International Accounting Standards Board (IASB) in its Regulatory Framework focuses on these issues.

The Statement of Principles seeks to identify why financial statements are produced; and whether they are meeting their objective. The reason it says, is: "to provide information about the financial position, performance and financial adaptability of an enterprise, that is useful to a wide range of users for assessing the stewardship of management and for making economic decisions".

To meet their basic objective financial statements must be useful; and the information relevant and reliable. Information will have relevance if it influences the decisions of the users. Irrelevant information has no use. Relevance and reliability are primary characteristics relating to content together with the threshold quality, materiality. The primary characteristics relating to presentation include comparability, clarity and understandability.

The Statement of Principles identifies the major user groups, as did the Corporate Report in the 70's.

The main user groups include:

- Investors / shareholders
- Employees
- Lenders
- Suppliers
- Customers

- Government
- Public

What then are the needs of these groups and how would they use the published statements?

Investor Group

This group would comprise both existing and potential shareholders. They would consider whether to invest or disinvest in the business.

Equity investors consider two elements to their investment, income and gain. Income in the form of dividends and gain in the share price.

If the investor takes a short-term view then current dividends are of interest. Whereas a longer-term view would concern future earnings.

A guide to the future can to some extent be seen in company reports with the chairman's statement, although based on current performance, company forward strategy is often included.

The investor group would also be interested in profitability and its trend over a period of time.

Employees

It is encouraging to note that some companies produce a separate employees report.

Employees and their representatives require information on business performance for two principal reasons:

- wage and salary negotiation
- assessment of current and forward opportunity in terms of employment

They would be interested in both the current financial stability and the longer-term financial viability of the business.

They need information in a clear, simple and understandable form.

I have seen some employee reports which include a value added approach rather than a profit and loss account view of performance.

Lenders

This is often referred to as the loan creditor group. It would include the long, medium and short term lenders of money.

The concern of the existing and/or potential loan creditor is "will they get their money back?"

A short-term loan creditor will immediately consider cash flow and the Cash Flow Statement based on FRS1, will be of particular interest here. The Banks make up much of this grouping and would also have an interest in the (NRV) net realisable value of the assets.

Medium and long-term creditor groups will review the future cash flow potential of the business.

A further consideration would be on the priority of claims on the business's resources.

They would have interest in current and future profitability and growth prospects of the entity.

Suppliers

This group comprises the trade creditors an important element in the supply of a business's working capital.

They would be interested in the financial stability of the business in terms of cash flow and the firm's ability to meet its short-term liabilities.

They would consider current and future cash flow together with current and future profitability.

An interest in the company's future strategy is also likely as they would need to consider how they, as suppliers, fit with the strategy.

Customers

This group will be interested in the business's short and longer term financial stability and its potential to supply high quality goods and services, with where appropriate, sound after sales service.

They may also have interest in the environmental policy of the business.

Government

The government departments require published financial information for the purposes of taxation – company taxation and VAT.

The government are decision makers and their forward economic plans are influenced by the performance of all businesses within various sectors in the economy.

The current financial reports will be used as a base in their economic models for assessing future performance.

Public

The public are often referred to as "shareholders" and businesses do not exist solely in isolation.

Businesses are part of society at large and as such generate much public interest.

At local and national level factors as employment and the environment are often key interests.

Some of these issues are included in their financial information and longer term strategy.

In this short paper I have used the term "businesses". However, we should be aware that public sector bodies eg: Local Authorities and NHS Trusts, together with non-profit making organisations and charities publish financial statements which are also relevant to wide based user groups.