

Say what you think ...

## Accounting sleights of hand replaced by puffery

FT

Philip Whitchelo

In 1992, Terry Smith published the first edition of his best selling exposé *Accounting for Growth*, of the methods by which some UK companies in the 1980s and 1990s had used (apparently legitimate) accounting techniques to turn losses into profits, expenditure into assets and debt into somebody else's liability.

Funnily enough, many of the companies that used such techniques (such as Tiphook, Queens Moat and Trafalgar House) had the nasty habit of blowing up as soon as the recession of the early 1990s took hold.

The most egregious examples of accounting trickery have since been outlawed by the Accounting Standards Board through the development of more robust accounting standards, recommended practices and other strictures, such that the

investor of the late 2000s could be forgiven for thinking that published company annual reports were in some way a useful guide to a company's business and to the likely risks (and rewards) that an investor in the equity of such companies could expect.

Nothing could be further from the truth.

A review of the published annual report and accounts of the banks that have imploded and showered us all with their toxic debris shows that the accounting sleights of hand of the 1980s have been replaced by a thick, glossy catalogue of useless puffery, where mindless box ticking compliance and endless committees stupefy the reader with page after page of irrelevant disclosure and really important information such as

the CO<sub>2</sub> output of bank branches, and per employee, and details of the water saving toilet-flushing system installed in head office.

Of the impending maelstrom, not a whisper.

The proper purpose of a company report and accounts – an honest description of a company's business model a realistic assessment of the risks and rewards to which the business is subject and a true picture of the balance sheet – has become almost totally obliterated

It is time for regulators, auditors and companies to put a halt to this farce and to return the annual report to its rightful place as a source of meaningful information for investors.

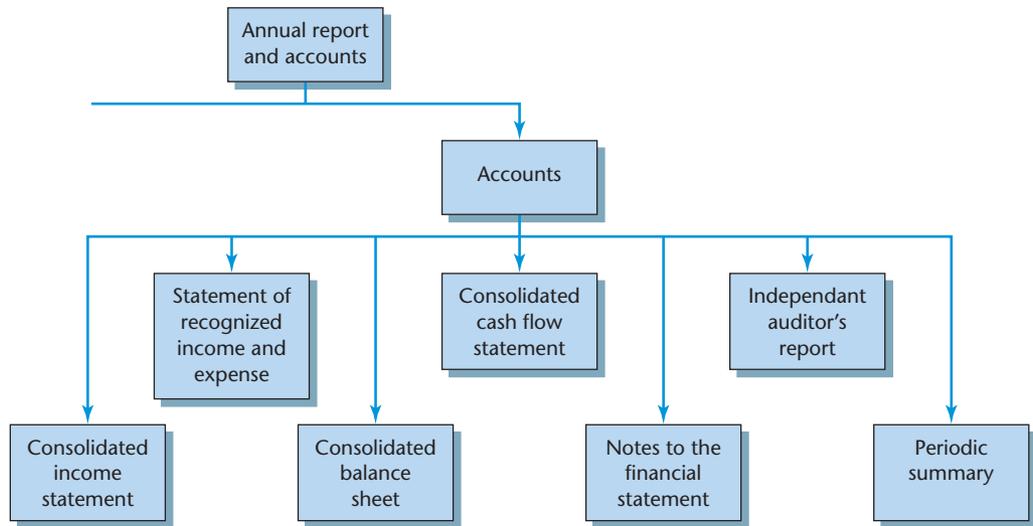
www.ft.com, 2 March 2009.

Source: Reproduced with permission from Philip Whitchelo, Interim M&A Partners Ltd, London.

Questions relating to this news story can be found on page 211 ➔

## About this chapter

This chapter is a continuation of Chapter 8. In that chapter we dealt with the various reports that you will find in a listed company's annual report and accounts. In this chapter we are going to look at what may be found in its annual *accounts*, such as a profit and loss account and a balance sheet. Figure 9.1 gives you an overview of what we will be covering in this chapter.



**Figure 9.1 Annual accounts: structure**

### Learning objectives

By the end of this chapter you should be able to:

- list the main seven reports and statements that are included in a public limited company's published annual accounts;
- outline what each of these reports and statements contain;
- locate additional information in the notes to the accounts;
- extract meaningful and useful information about the company's performance from the accounts;
- evaluate the significance of the auditor's report;
- review the company's financial performance over the longer term.

### ! Why this chapter is important

The various *reports* included in a company's published annual report and accounts are important for non-accountants because they provide a great deal of background information about the company and its operations. Much of this information is now mandatory either by statute or by professional requirements.

Apart from the periodic summary most of the accounts section is mandatory. The information that it contains is considered vital because it tells shareholders and other users what profit the company has made, what its cash flow is like, what assets it owns and what liabilities it has incurred. Such information can provide the basis for a rigorous analysis of the company's performance in order to help assess its future prospects.

In the next chapter we shall explain how you can go about undertaking such an analysis. Accountants refer to it as 'interpreting the accounts', or as the man in the street might say, 'reading between the lines of the balance sheet'. This chapter provides you with the basic information that will enable you to interpret a set of accounts.

**Activity 9.1**

Turn to the three sets of the annual report and accounts that you used in the previous chapter. Find out what accounts are included in each of them and then list their titles in three adjacent columns.

**Setting the scene****News clip****No better off?**

A recent study suggests that IFRS prepared financial statements are not necessarily easier to compare than they were under locally determined generally accepted accounting principles. However, the study showed that profits were higher under IFRS but balance sheets worse off.

Source: Adapted from [www.accountancyage.com/articles/2229902](http://www.accountancyage.com/articles/2229902).

This section is divided into two parts. In the first part we give you a brief reminder of some of the material we covered in Chapter 2, while in the second part we explain what is meant by group accounts.

**International financial reporting standards**

Unlike most of the previous chapters in this book, in this one we are dealing with the *published* accounts of a limited liability company. And if the accounts have been published then that probably means that the company is *listed*, i.e. it is a public limited liability company and you can buy its shares on the Stock Exchange. We will also assume that it is incorporated in the United Kingdom but most of the points that we cover in this chapter are relevant even if the company is incorporated in one of the other 26 member countries of the European Union.

It is important that we make the above assumptions clear, particularly about the EU. In the UK the accounting requirements are included in the Companies Act 2006. As we mentioned in Chapter 2, the Act requires group listed companies to prepare accounts under IAS requirements. In this respect the Act simply incorporates EU law into British law. Other EU countries have had to do the same thing. This means that *all* group listed companies throughout the EU have had to adopt IAS requirements. So perhaps apart from the language and the currency you should find that group listed company accounts throughout the EU look similar in both content and presentation.

The main requirements affecting the presentation of published accounts under the IASB programme may be found in *IAS 1 (Presentation of Financial Information)*, *IAS 7 (Cash Flow Statements)*, *IAS 27 (Consolidated and Separate Financial Statements)*, and *IAS 28 (Accounting for Investments in Associates)*. All IASs will eventually be replaced by IFRSs but the old IASs remain valid until that happens.

There are two other matters that will also be new to you when you come across a set of published accounts although these have not come about as a result of adopting the international accounting standards. They are:

- corresponding figures for the preceding year will be included side by side with the current year;
- most published accounts will be for a *group* of companies.

We deal with group accounts in a little more detail below.

## Group accounts

We referred to ‘groups’ in Chapter 2. A group of companies is like a family. One company (say Company A) may buy shares in another company (say Company B). When Company A owns more than 50 per cent of the voting shares in Company B, B becomes a *subsidiary* of A. If A were to own more than 20 per cent but less than 50 per cent of the voting shares in B, B would be known as an *associated company* of A. In effect, B is considered to be the offspring of A. Of course B might have children of its own, say Company C and Company D. So C and D become part of the family, i.e. part of the A group of companies. An example of a group structure is shown in Figure 9.2.

The main significance of these relationships is that you can expect the published accounts to be those of the *group*, i.e. in effect, as though it were one entity so that any intergroup activities (such as sales between group companies or transfers of funds) are ignored. This involves adding together all the accounts of the group companies, or *consolidating* them. Using IASB terminology you can, therefore, expect a published set of accounts to include a *consolidated* income statement, a *consolidated* statement of recognized income and expense (or changes in equity), a *consolidated* balance sheet and a *consolidated* cash flow statement. Note that instead of using the term ‘consolidated’ some companies substitute ‘group’. Such statements are now considered in turn in the following sections.

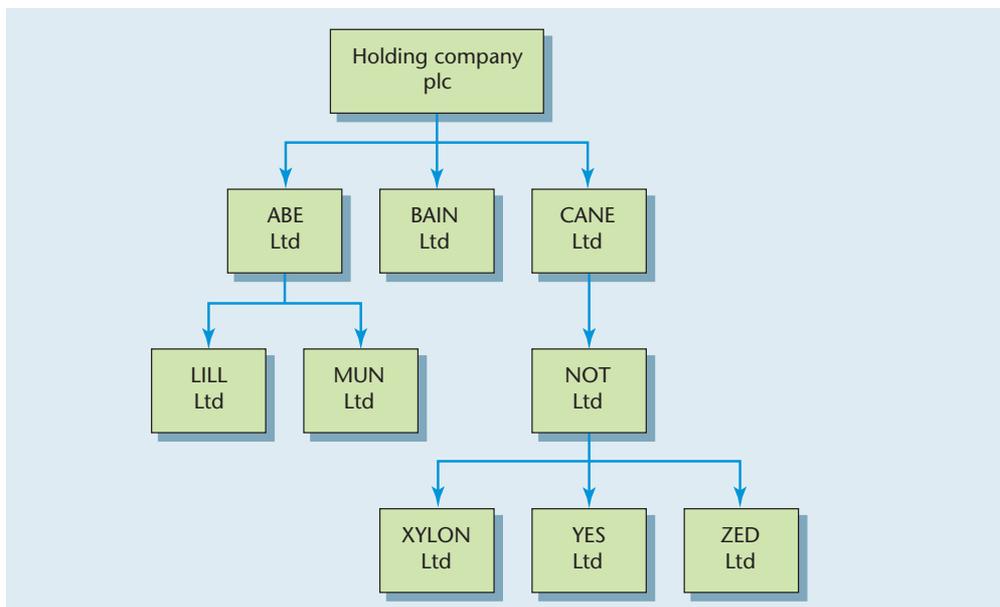


Figure 9.2 Example of a group company structure

## Consolidated income statement

### News clip

## Scots invade England

A.G. Barr, the Scottish soft drink manufacturer, reported better results than expected. Sales were boosted by a free glass promotion and increased penetration of the English market.

Source: Adapted from *The Guardian*, 4 September 2008, p. 28.

We show a consolidated income statement prepared under IASB requirements in Example 9.1.

### Example 9.1

## A consolidated income statement

### A.G. Barr plc Consolidated income statement for the year to 31 January 2009

	<i>Tutorial notes</i>	<i>£000</i>
<b>Revenue</b>	1	169 698
Cost of sale	2	<u>84 962</u>
<b>Gross profit</b>	3	84 736
Net operating expenses	4	<u>61 552</u>
<b>Operating profit</b>	5	23 184
Operating profit before exceptional items	6	23 054
Exceptional item (credit)	6	(130)
Operating profit	7	23 184
Finance income	8	1 062
Finance costs	9	<u>(1 037)</u>
<b>Profit before tax</b>	10	23 209
Tax on profit	11	<u>6 134</u>
<b>Profit attributable to equity shareholders</b>	12	<u><u>17 075</u></u>
<b>Earnings per share</b>		
Basic earnings per share	13	89.12p
Diluted earnings per share	13	88.16p
<b>Dividends</b>		
Dividends per share paid	14	39.60p
Dividend paid (£000)	15	7 604
Dividend per share proposed	16	30.40p
Dividend proposed (£000)	17	5 916

A.G. Barr plc, *Annual Report and Accounts*, January 2009.

*Note:*

References to the formal notes and the notes themselves have not been reproduced in the above example.

**Tutorial notes to  
Example 9.1  
continued**

- 1 *Revenue*. The net invoiced sales value exclusive of value added tax of goods and services supplied to external customers during the year.
- 2 *Cost of sales*. No details were disclosed except that the amount does not include distribution costs and administration expenses (see Tutorial Note 4 below). As there are no other operating expenses we can assume that it includes only raw material and production costs.
- 3 *Gross profit*. Gross profit is normally defined as the difference between sales revenue and purchase costs (after allowing for opening and closing stock). In published accounts production costs are also usually included.
- 4 *Net operating expenses*. Distribution costs and administrative expenses reduced by a provision for £130,000 no longer required.
- 5 *Operating profit*. This is the profit that the company has earned during the year on its normal manufacturing and selling activities.
- 6 *Operating profit before exceptional items*. The operating profit as above less the exceptional item of £130,000. The provision of £130,000 is no longer needed so it is written back to the income statement. Exceptional items are costs and income that are not expected to recur in the normal course of business.
- 7 *Operating profit*. As above.
- 8 *Finance income*. Interest receivable.
- 9 *Finance costs*. Interest payable.
- 10 *Profit before tax*. The profit made on the company's activities during the year before taking into account any taxation due on it.
- 11 *Tax on profit*. The tax amount will be mainly corporation tax payable on the profits for the year adjusted for amounts relating to other years.
- 12 *Profit attributable to equity holders*. This is the overall profit for the year after allowing for tax. In theory it could all be paid out to the shareholders.
- 13 *Earnings per share*. The basic earnings per share are the profit for the year attributable to equity holders divided by the weighted average number of ordinary shares in issue during the year. The diluted earnings per share are calculated similarly to the basic earnings per share except that an allowance is made for some shares that *might* be issued if the right to take them up is exercised.
- 14 *Dividend per share*. What shareholders received in dividend during 2008/09 for each share that they held. It includes dividends relating to the previous year plus an interim dividend for 2008/09 both paid out during the current year.
- 15 *Dividend paid*. This is the total cost of the dividends paid out during 2008/09.
- 16 *Dividend per share proposed*. The dividend per share held that the directors recommend should be paid, i.e. the 'final' dividend for the year. If approved by the shareholders it will be paid out during 2009/10.
- 17 *Dividend proposed*. This is the total cost of the proposed final dividend.

Barr has presented its consolidated income statement by aggregating its expenses according to *function*, i.e. by itemizing the cost of sales, distribution costs and administrative expenses. This is known as the *operational* format and most companies adopt it. An alternative format is to aggregate expenses according to their *nature* by itemizing changes in inventories of finished goods and work in progress, raw materials and consumables, depreciation and amortization expenses, and other operating expenses. This is known as the *type of expenditure* format. The chances are that you will not come across this format very often. There is no difference in presentation between the two formats after the operating profit line.

**Activity 9.2**

Refer to your three sets of annual accounts and turn to the page that includes the consolidated income statement. Read down through the statement on a line-by-line basis. If you do not understand a particular item look it up in the 'notes to the accounts'. Compare your three statements with Example 9.1 and list any significant differences between them.

**Statement of recognized income and expense**

Besides an income statement IAS require another primary statement called the *Statement of Changes in Equity*. However, an alternative version is permitted: the *Statement of Total Recognized Gains and Losses*. This version is the one that we have chosen to adopt in this chapter as it is the one you are most likely to come across in the UK. Both types of statement serve a similar purpose.

The objective of the statement is to disclose *all* gains and losses of the company during the financial year and not just those that have been included in the income statement. Gains or losses on the revaluation of property, for example, are not normally taken to the income statement until they have been realized, i.e. when the property has been sold. So until they are, any gains or losses should be included in this particular statement. Other examples include currency translation differences on foreign currency net investments, unrealized gains or losses on trade investments, and adjustments that relate to the previous year.

The statement should be presented immediately following the income statement. Example 9.2 shows Cairn Energy's statement of recognized income and expense for 2008.

**Example 9.2****A statement of recognized income and expense**

**Cairn Energy plc**  
**Statement of recognized income and expense for the year ended 31 December 2008**

	<i>Tutorial notes</i>	<i>Group 2008 \$m</i>
<b>Income and expense recognized directly in equity</b>		
(Deficit)/surplus on valuation of financial assets	1	(14.0)
Currency translation differences	2	(150.6)
<b>Total (expense)/income recognized directly in equity</b>		<u>(164.6)</u>
<b>Profit/(loss) for the year</b>	3	<u>366.7</u>
<b>Total recognized income and expense for the period</b>		202.1
Attributable to:		
Equity holders of the parent	4	236.5
Minority interests	5	<u>(34.4)</u>
		<u><u>202.1</u></u>

Cairn Energy plc, *Annual Report and Accounts*, 2008.

*Note:*

Reference to the formal notes, the notes themselves, the company's results and the 2007 results have not been reproduced.

**Tutorial notes to  
Example 9.2  
continued**

- 1 Investments.
- 2 Unrealized foreign exchange gains less losses.
- 3 The profit for the year brought in from the income statement.
- 4 The group majority shareholders' share of the realized and unrealized income for the year after allowing for the minority shareholders' share.
- 5 The remaining shareholders' share of the realized and unrealized income for the year.

**Activity 9.3**

Look up the statement of recognized income and expense in each of your three accounts. List all the various items (there should not be many) in each statement in adjacent columns.

## Consolidated balance sheet

Most published balance sheets are now presented in the vertical format (like the other financial statements), i.e. the items are listed on a line-by-line basis from the top of the page to the bottom. It is also customary to group the items into various categories, such as fixed assets and current assets. This is the approach adopted by the IASB.

There is no prescribed format but current assets should be separated from non-current assets and liabilities. Otherwise you can expect variations in the way that companies present the information that *must* be disclosed on the face of the balance sheet. Generally, however, you will probably find that most companies start with the non-current assets, followed by the current assets to arrive at *total assets*. This will then be followed in sequence by three sections listing the capital and reserves, the non-current liabilities and the current liabilities. The total will be described as the *total equity and liabilities*. This balance should, of course, be the same as the total assets.

### News clip

## Swings and roundabouts

The IASB is proposing that certain types of investment held by banks and insurance companies should be shown on the balance sheet at their market value. This is likely to mean that the balance sheet will be much more meaningful. However, the profit for the year will be become more erratic because any changes in the market value from year to year will be written off to it.

Source: Adapted from *The Financial Times*, 15 July 2009.

Example 9.3 is a reasonably simple presentation of a group balance sheet although we have not included the previous year's balance sheet or the formal notes relating to the current one.

**Example  
9.3**
**An example of a published balance sheet**
**J. Smart & Co (Contractors) PLC and Subsidiary Companies  
Consolidated Balance Sheet as at 31 July 2008**

	<i>Tutorial notes</i>	<i>2008 £000</i>
<b>Non-current assets</b>		
Property, plant and equipment	1	4 331
Investment properties	2	68 148
Investments in joint ventures	3	2 067
Financial assets	4	1 533
Trade and other receivables	5	3 176
Deferred tax assets	6	936
		<u>80 191</u>
<b>Current assets</b>		
Inventories	7	8 184
Trade and other receivables	5	3 833
Cash at bank and in hand		18 390
		<u>30 407</u>
<b>Total assets</b>		<u><u>110 598</u></u>
<b>Non-current liabilities</b>		
Retirement benefit obligations	8	1 089
Deferred tax liabilities	6	5 944
		<u>7 033</u>
<b>Current liabilities</b>		
Trade and other payables	9	5 518
Current tax liabilities		733
		<u>6 251</u>
<b>Net assets</b>		<u><u>13 284</u></u>
<b>Total equity</b>		<u><u>97 314</u></u>
<b>Equity</b>		
Called up share capital	10	1 088
Fair value reserve	11	(127)
Retained earnings	12	96 433
<b>Total equity</b>		<u><u>97 314</u></u>

J. Smart & Co (Contractor) PLC, *Annual Report and Accounts*, 2008.

**Tutorial notes to  
Example 9.3**

- 1 Shown at cost or valuation after allowing for additions, disposals and depreciation.
- 2 Properties earning rental income. Shown at cost or valuation after allowing for additions, disposals, and gains and deficits on valuation.
- 3 Joint ventures are contractual activities taken with other parties subject to the control of them all. So these are investments in companies where there is such an arrangement.
- 4 Listed investments.
- 5 Non-current assets are loans to joint venture companies. Current assets include: trade debtors, other receivables, prepayments, and amounts recoverable on contracts.
- 6 Deferred taxation: tax due to or from the tax authorities beyond the financial year.



**Tutorial notes to  
Example 9.3  
continued**

- 7 Long-term contracts balances, land, raw materials, consumables and finished goods.
- 8 Liabilities under the company's pension scheme.
- 9 Trade creditors, other creditors and loans from joint venture companies.
- 10 Ordinary shares of 10p each.
- 11 Fair value: amounts at which assets could be exchanged or liabilities settled; so this is an amount set aside for that purpose.
- 12 Profit retained within the business for future investment.

**Activity 9.4**

Referring to your set of three published accounts, work your way down each of the three consolidated balance sheets. If you do not understand what any of the items mean, consult the 'notes to the accounts'. Then compare Smart's main section headings to those in each of your three balance sheets. Note any differences in the description of the headings and the order in which they are presented. Assuming that there are some differences between them, which format do you think is the easiest to follow?

## Consolidated cash flow statement

We dealt with cash flow statements (CFSs) in Chapter 7. Towards the end of that chapter we used a simple example to explain the difference between an ASB prepared CFS and an IASB one. The requirements are spelt out in the ASB's FRS 1 and the IASB's IAS 7. The main differences between them are as follows:

- *Exemptions:* IAS 7 does not permit any exemptions.
- *Definition of cash:* FRS 1 uses a narrow definition of cash whereas IAS 7 includes 'cash equivalents'.
- *Presentation:* FRS 1 requires eight main headings: operating activities, returns on investments and servicing of finance, taxation, capital expenditure and financial investment, acquisitions and disposals, equity dividends paid, management of liquid resources, and financing. IAS 7 uses three main headings: operating, investing and financing.
- *Disclosures:* FRS 1 requires some disclosures to be made about 'net debt'; IAS 7 does not make this a formal requirement.

With these differences in mind we can now look at a group CFS prepared under IASB requirements. We do so in Example 9.4.

In Example 9.4 we haven't reproduced either the 2007 comparative figures or the notes (there were three including one converting the profit for the year into 'cash generated from operations'). Aggreko did also include a reconciliation of net cash flow to the movement in net debt. The company used A5-sized paper for its annual report and accounts but even with the net debt reconciliation its CFS took up less than one page. It looks, therefore, highly presentable and straightforward. Whether the contents actually mean much to the average reader is a different matter.

**Activity 9.5**

Turn to the cash flow statements in each of your three accounts. Examine the terminology, the presentations and layout of each CFS along with Aggreko's. Are there any substantial differences between the four CFSs? If there are, make a note of them. Then extract the two or three most significant items in each CFS that have resulted in an increase or a decrease in cash and cash equivalents during the year.

**Example  
9.4**
**Example of a published cash flow statement for a plc**

**Aggreko plc**  
**Group cash flow statement for the year ended 31 December 2008**

	2008 £m
<b>Cash flows from operating activities</b>	
Cash generated from operations	276.1
Tax paid	(39.6)
Net cash generated from operating activities	<u>236.5</u>
<b>Cash flows from investing activities</b>	
Acquisitions (net of cash acquired)	(15.9)
Purchases of property, plant and equipment (PPE)	(265.2)
Proceeds from sale of PPE	9.0
Net cash used in investing activities	<u>(272.1)</u>
<b>Cash flows from financing activities</b>	
Net proceeds from issue of ordinary shares	1.3
Increase in long-term loans	185.7
Repayment of long-term loans	(107.1)
Net movement in short-term loans	4.9
Interest received	0.5
Interest paid	(14.6)
Dividends paid to shareholders	(23.7)
Purchase of treasury shares	(13.2)
Sale of own shares by Employee Benefit Trust	0.9
Net cash from/(used in) financing activities	<u>34.7</u>
<b>Net decrease in cash and cash equivalents</b>	
Cash and cash equivalents at beginning of year	(0.9)
Exchange gain on cash and cash equivalents	1.6
Cash and cash equivalents at end of year	<u>10.3</u>

Aggreko plc, *Annual report and accountants*, 2008.

## Notes to the financial statements

The income statement, the statement of recognized income and expense and the balance sheet are usually supported by a great deal of additional notes. These notes serve two main purposes:

- they avoid too much detail being shown on the face of the financial statements;
- they make it easier to provide some supplementary information.

IASB requirements specify what information *must* be disclosed on the face of the financial statements. This means that the notes can stretch to many pages. Aggreko's 2008 notes to the accounts, for example, are 33 pages long (on A5 paper). Cairn Energy, one of the top 100 companies in the UK, has 51 pages of notes (on A4 paper). This is an awful lot of

information to plough through and you have to be a dedicated shareholder to do so. The ASB, in its 1999 *Statement of Principles for Financial Reporting*, expected financial information to be understandable, but only if users had:

*a reasonable knowledge of business and economic activities and accounting and a willingness to study with reasonable diligence the information provided.*

After studying the information in some financial statements (no doubt reasonably diligently) you could perhaps be forgiven if you felt that the ASB was being just a little bit too optimistic in its expectations.

## Independent auditor's report

### News clip

## Concern over Southampton FC

Southampton Football Club's parent company has failed to publish its results and its shares have been suspended. Apparently the auditors have not signed the accounts as there are doubts that the company is able to operate as a 'going concern'.

Source: Adapted from [www.accountancyage.com/articles/print/2239558](http://www.accountancyage.com/articles/print/2239558).

In some companies you will find the independent (i.e. external) auditor's report before the financial statements, while others include it after the 'notes to the accounts'.

The independent auditor is required to do the audit and then to report to the shareholders in accordance with relevant legal and regulatory requirements. Most reports will be short – probably no longer than one page – and unless some highly unusual events have taken place, most auditors' reports will be very similar. Aggreko's independent auditors' report (note the plural) is reproduced in Figure 9.3. Read through it very carefully. The following features are of particular interest.

- 1 The independent auditors have audited not only the financial statements but also parts of the director's remuneration report (as required).
- 2 There is quite a long statement explaining the respective responsibilities of the directors and of the auditors. Note what they are.
- 3 The audit has been conducted on the basis of international auditing standards (UK and Ireland).
- 4 The auditors explain what was involved in doing the audit (basis of audit opinion).
- 5 The auditors confirm that the group financial statements give a 'true and fair' view for the period in question.
- 6 This opinion is in accordance with IFRS requirements and the provision of the 1985 Companies Act (in later years this will become the 2006 Companies Act) and IAS regulations.

### Independent Auditors' Report to the Members of Aggreko plc

We have audited the Group financial statements of Aggreko plc for the year ended 31 December 2008 which comprise the Group Income Statement, the Group Statement of Recognised Income and Expense, the Group Balance Sheet, the Group Cash Flow Statement and the related notes. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Aggreko plc for the year ended 31 December 2008 and on the information in the Directors' Remuneration Report that is described as having been audited.

#### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group financial statement in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the Directors' Report is consistent with the group financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited group financial statements. The other information comprises only the Directors' Report, the Chairman's Statement and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

#### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the group financial statements, and of whether the accounting policies are appropriate to the group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the group financial statements.

**Figure 9.3** An example of an independent auditors' report (*continues overleaf*)

**Opinion**

In our opinion

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31st December 2008 and of its profit and cash flows for the year then ended; and
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group financial statements.

*PricewaterhouseCoopers LLP*

**PricewaterhouseCoopers LLP**

**Chartered Accountants and Registered Auditors, Glasgow**

5 March 2009

**Figure 9.3 (continued) An example of an independent auditors' report**

Source: Aggreko plc, *Annual Report and Accounts*, 2008.

**Activity 9.6**

Find the auditor's report in each of your three accounts. Read through them. Does the auditor state that the accounts represent a 'true and fair' view or are there any qualifications or reservations about something in the financial statements? If there are any qualifications (probably introduced by the phrase 'except for ...'), list them.

**Periodic summary**

Many companies include a periodic summary as part of their accounts. The usual period covered is five years but sometimes it may be ten. The summary will usually be found after the 'notes to the accounts'.

As there are no IASB requirements to produce such a summary companies are free to choose how it should be presented and what to put in it. Even so the independent auditor is required to report 'on other information contained in the Annual Report' to ensure that 'it is consistent with the audited Group financial statements' (see Figure 9.3). So companies are not entirely free to publish just what suits them.

We suggest that in most periodic summaries you will find some details about the sales revenue, gross profit, profit before tax, and dividends paid. You might also find some items extracted from the balance sheet such as fixed assets, some non-current liabilities, and the retained earnings.

Although periodic statements are limited in scope they can help users to assess the company's performance over a much longer period than the two years that are legally required (the current year's result and the previous one). This is a significant point because conventional financial statements prepared on an annual basis may not suit some companies whose activities are much more long-term. As a result the preparation of financial statements on such a short-term basis may be highly misleading. Periodic summaries may help, therefore, to give a much fairer picture of the company's affairs although there does not appear to be any current plans to make them mandatory.

A typical periodic summary is shown in Example 9.5.

**Example  
9.5**
**Example of a periodic summary**

Devro plc					
Financial summary for the year ended 31 December 2008					
	2008	2007	2006	2005	2004
	<i>£million</i>	<i>£million</i>	<i>£million</i>	<i>£million</i>	<i>£million</i>
Revenue	183.1	156.3	152.8	152.5	148.9
Operating profit before exceptional items	20.6	17.7	19.7	21.6	21.9
Exceptional items	(3.5)	0.6	(1.0)	6.3	–
Operating profit	17.1	18.3	18.7	27.9	21.9
Profit before tax	15.3	16.2	16.9	25.8	18.0
Profit after tax	12.4	12.0	12.4	18.7	12.9
Net assets	111.3	95.1	73.2	61.4	53.3
Earnings per share:					
– Basic	7.6p	7.4p	7.7p	11.5p	8.0p
– Diluted	7.6p	7.4p	7.6p	11.4p	7.9p
– Before exceptional items	8.2p	6.4p	8.1p	8.7p	8.0p
Dividends per share	4.45p	4.45p	4.45p	4.4p	4.0p
Net assets per share	68.3p	58.4p	44.9p	37.9p	33.0p

Source: Devro plc, *Annual report and accounts*, 2008.

Note:

Two brief explanatory notes have not been reproduced in the above example.


**Questions you should ask**

It is probably only at a very senior level that you would be in a position to ask questions about your company's draft annual report and accounts prepared for publication, but if you get the opportunity the following ones might be pertinent.

- Are we absolutely confident that we have complied with the minimum statutory and mandatory accounting statements?
- Can we reduce the number of pages without missing out any essential information?
- Would it be possible to use different formats so that users not trained in accounting can follow them more easily?
- Can any item be left out to make it easier for users to understand?
- Could we avoid professional jargon and substitute terms that the layperson would understand?

## Conclusion

In this chapter we have examined the accounts section of a number of listed companies' annual report and accounts. We have suggested that it is possible to group the various types of financial statements into seven major categories:

- income statement
- statement of recognized income and expense
- balance sheet
- cash flow statement
- notes to the accounts
- auditor's report
- periodic summary.

All these statements, except the periodic summary, are mandatory for UK and other EU group listed companies. This now means that they have to be prepared in accordance with IASB requirements. When they are combined with the 'reports' (discussed in the last chapter) they can form quite a formidable document especially for a very large international group of companies. Overall the annual report and accounts is supposed to provide sufficient information for shareholders to be satisfied that their company is being managed effectively and efficiently. However, it may be that the sheer amount of information does not enable shareholders to be entirely reassured. There can be such a thing as 'information overload'!

### Key points

- 1 An annual report and accounts contains a great many statements but those relating to the accounts (often referred to as the 'financial statements') may take up to about half of the entire contents.
- 2 The accounts section will include an income statement, a statement of recognized income and expense, a balance sheet (two if the accounts deal with a group of companies), a cash flow statement, notes to the accounts, an auditor's report and a periodic summary.
- 3 As a part of the EU all UK group listed companies are required to adopt IASB standards in the preparation of their financial statements.
- 4 *IAS 1* specifies the format of the income statement and the balance sheet, the contents and the sectional heading. *IAS 7* covers the cash flow statement.
- 5 A minimum amount of information is usually shown on the face of the various statements with the remaining mandatory information being shown in notes to the accounts.

## Check your learning

*The answers to these questions can be found within the text.*

- 1 What is meant by 'disclosure'?
- 2 What is a group of companies?
- 3 What are consolidated accounts?
- 4 Which main international accounting standard covers the presentation of accounts?
- 5 What is meant by the 'operational' and 'type of expenditure' formats for the presentation of the income statement?
- 6 Is it permissible for a company to include any proposed dividends in its income statement?
- 7 Name two items that you might find in a statement of recognized income and expense.
- 8 What is meant by the terms 'current' and 'non-current' in a company's balance sheet?
- 9 Give an example of a non-current liability.
- 10 What international accounting standard covers the preparation of a listed company's cash flow statement?
- 11 How many main headings are there in a listed company's cash flow statement?
- 12 Why are 'notes to the accounts' used?
- 13 What opinion does an independent auditor usually express about a company's financial statements?
- 14 What mandatory requirements cover the publication of a periodic summary statement?

## News story quiz

*Remember the news story at the beginning of this chapter? Go back to that story and reread it before answering the following questions.*

You will gather that the writer of this letter published in the *Financial Times* is fairly critical of published company reports and accounts.

### Questions

- 1 Do you think that current reports and accounts are a 'thick, glossy catalogue of useless puffery'?
- 2 Is the reader of published accounts supplied with 'page after page of irrelevant disclosure' at the exclusion of more important matters?
- 3 How far do you agree with the writer's view of the purpose of company reports and accounts?

## Tutorial questions

- 9.1 What items do you think could be taken out of a listed company's published income statement and its balance sheet without affecting the usefulness of such statements?
- 9.2 Describe what is meant by a 'qualified audit report' illustrating your answer with appropriate examples.
- 9.3 Suggest ten items that should be disclosed in a listed company's periodic summary statement.

Further practice questions, study material and links to relevant sites on the World Wide Web can be found on the website that accompanies this book. The site can be found at [www.pearsoned.co.uk/dyson](http://www.pearsoned.co.uk/dyson)