# UNIT 2
# MANAGING FINANCIAL RESOURCES AND DECISIONS

Unit Code: H/601/0548

Credit Value: 15

# MANAGING FINANCIAL RESOURCES AND DECISIONS

- **LO 4: Be able to evaluate the financial performance of a business.**


# THE BASIC SYLLABUS

- Understand the sources of finance available to business.
- Understand the implications of finance as a resource within a business
- Be able to make financial decision's based on financial information
- Be  able to evaluate the financial performance of a business.

# LEARNING OBJECTIVE


- At the end of the class students should be able to:
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- AC 4. 2: Compare appropriate formats of financial statements for different types of business

# OVERVIEW

- There are four forms of business organizations: sole proprietorships, partnerships, limited liability companies and corporations. A sole proprietorship is a business owned by one person. Many small service enterprises, retail stores and professional practices are operated as proprietorships. The owner is the legal owner of its assets, is legally liable for its debts and is entitled to all the earnings of the proprietorship. From an accounting standpoint, however, the business is treated as a separate entity from its owner.

# BASIC FORM

- Companies use basic financial statements to communicate a company's financial information to outsiders - parties other than the company's directors and managers, who are the "insiders.“
- Financial statements have generally agreed-upon formats and follow the same rules of disclosure. This puts everyone on the same level playing field, and makes it possible to compare different companies with each other, or to evaluate different year's performance within the same company. There are three main financial statements:
- Income Statement
- Balance Sheet
- Statement of Cash Flows

# BASIC FORM

- Each financial statement tells it's own story. Together they form a comprehensive financial picture of the company, the results of its operations, its financial condition, and the sources and uses of its money. Evaluating past performance helps managers identify successful strategies, eliminate wasteful spending and budget appropriately for the future. Armed with this information they will be able to make necessary business decisions in a timely manner.

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – BALANCE SHEETS

- Another name for the balance sheet is the statement of financial position. Creditors and interested stock investors use the balance sheet to determine a company's financial standing because it lists what a company owns and what it owes. The balance sheet contains summarized information on a company's assets -- the things that it owns and its liabilities -- the debts it has. When you subtract the company's liabilities from the assets, what is left is called stockholder's equity, the amount that is held by the company's owners or stockholders. The balance sheet always balances because of the use of "double-entry" bookkeeping to record business transactions.

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – INCOME STATEMENT

- An income statement shows how much money the company made in a defined time period, such as last month, last quarter or last year. The statement starts with the money the company brought in and then subtracts the expenses associated with producing that income, such as the cost of supplies, payroll and office rental. This statement also subtracts expenses such as depreciation and any items that were returned. When all of the deductions are made, the result is the company's net income or net loss for the time period show on the statement.

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – CASH FLOW STATEMENTS

- The statement of cash flows (SCF) is an important financial statement that shows the details of the company's cash flows for an accounting period. It tells us how much cash has been received or paid by a business during its accounting period. In addition, it discloses the sources (how the cash has been generated) and disbursement of cash (how the cash has been utilized).

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – CASH FLOW STATEMENTS

- A company's total cash flows during its accounting period is generally categorized as operating , investing and financing cash flows. To properly report these three types of cash flows, the statement of cash flows is divided into three sections – operating activities section, investing activities section, and financing activities section.

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – NOTES

- Financial statement footnotes are explanatory and supplemental notes that accompany the financial statements issued by an entity. The exact nature of these footnotes varies, depending upon the financial framework used to construct the financial statements (such as GAAP or IFRS).

# THE STRUCTURE AND PURPOSE OF MAIN FINANCIAL STATEMENTS – NOTES

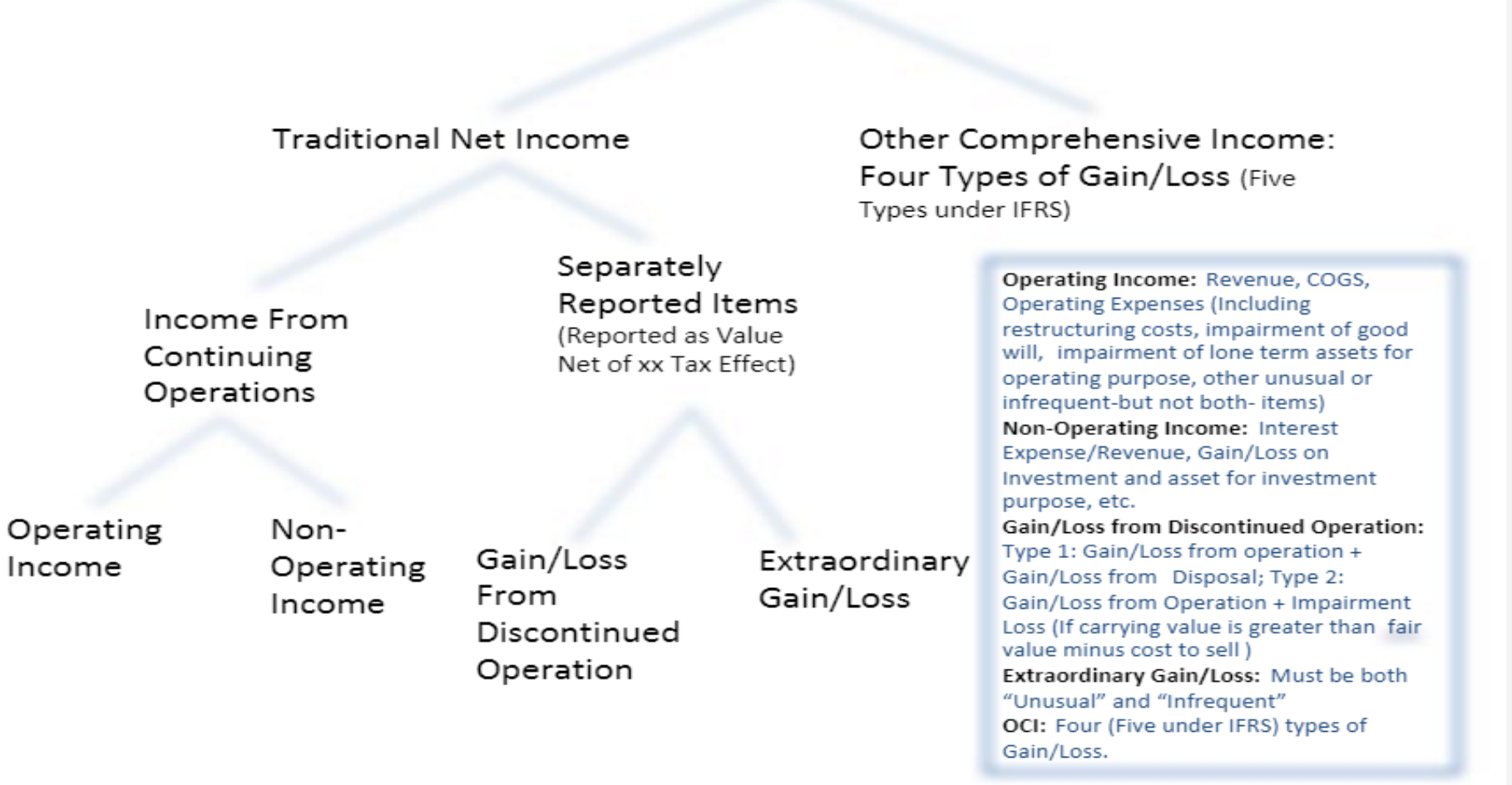
- Financial statement footnotes are an integral part of the financial statements, so you must issue them to users along with the financial statements. They are extremely valuable to the financial analyst, who can discern from the footnotes how various accounting policies used by a company are impacting its reported results and financial position.

# STATEMENT OF COMPREHENSIVE INCOME

- A comprehensive income statement begins at the place where an ordinary income gets started. It begins with the net profit plus or minus losses or gains that are not realized in the income statement. Rather, they are directly showed in the equity section of the concerned company.
- Tracking individual comprehensive income statement can help a company come by valuable information regarding many-sided financial stability of the concerned business. A comprehensive income statement is usually prepared by the accountants of a company. It seeks to demonstrate total comprehensive income earned by a business entity.

# STATEMENT OF COMPREHENSIVE INCOME

- Comprehensive Income



# STATEMENT OF FINANCIAL POSITIONS

- Statement of financial position accounts are classified. That is, a statement of financial position groups together similar items to arrive at significant subtotals. Furthermore, the material is arranged so that important relationships are shown.
- The IASB indicates that the parts and subsections of financial statements are more informative than the whole. Therefore, the IASB discourages the reporting of summary accounts alone (total assets, net assets, total liabilities, etc.).

# STATEMENT OF FINANCIAL POSITIONS

- Instead, companies should report and classify individual items in sufficient detail to permit users to assess the amounts, timing, and uncertainty of future cash flows. Such classification also makes it easier for users to evaluate the company's liquidity and financial flexibility, profitability, and risk.
- To classify items in financial statements, companies group those items with similar characteristics and separate items with different characteristics. For example, companies should report separately:

# TYPES OF BUSINESS – LIMITED COMPANY

- A limited company is an organisation that you can set up to run your business - it's responsible in its own right for everything it does and its finances are separate to your personal finances.
- Any profit it makes is owned by the company, after it pays Corporation Tax. The company can then share its profits.
- Most limited companies are 'limited by shares'. This means that the shareholders' responsibilities for the company's financial liabilities are limited to the value of shares that they own but haven't paid for.
- Company directors aren't personally responsible for debts the business can't pay if it goes wrong, as long as they haven't broken the law.

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# TYPES OF BUSINESS – LIMITED COMPANY

- There are two types of limited Company:-

- 1) Private company limited by guarantee
- Directors or shareholders financially back the organisation up to a specific amount if things go wrong.

- 2.) Public limited company
- The company's shares are traded publicly on a market, such as the London Stock Exchange

# TYPE OF BUSINESS - PARTNERSHIP

- Partnerships are businesses owned by two or more people. A contract called a deed of partnership is normally drawn up. This states the type of partnership it is, how much capital each party has contributed, and how profits and losses will be shared. Doctors, dentists and solicitors are typical examples of professionals who may go into partnership together. They can benefit from shared expertise, but like the sole trader, have unlimited liability. A partnership can also have a sleeping partner who invests in the business but does not have dealings in the day to day running of the enterprise.

# TYPE OF BUSINESS –SOLE TRADER

- A sole trader describes any business that is owned and controlled by one person, although they may employ workers, eg a newsagent's shop. Individuals who provide a specialist service like hairdressers, plumbers or photographers, are also sole traders. Sole traders do not have a separate legal existence from their owner. As a result, the owners are personally liable for the firm's debts, and may have to pay them out of their own pocket. This is called unlimited liability .


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