

SIM KAPILAUSE AND ABUSE OF  
FINANCIAL STATEMENTS

1. Introduction
2. Types of financial statements
3. Reliance on financial statements
4. Some key issues
5. Balance sheets
6. Profit and loss accounts
7. Other aspects of financial statements
8. Summing up

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SIM KAPILAUSE AND ABUSE OF  
FINANCIAL STATEMENTS

1. Introduction
  - (a) Background
  - (b) Objectives
    - Different types of financial statements
    - Reliance placed on financial statements
    - Key aspects of balance sheets and profit and loss accounts
  - (c) Importance of financial statements
    - Relevance in different types of litigation
    - Important for overview and to identify information requirements

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2. Types of financial statements
  - (a) Unincorporated businesses
    - Mingled with personal affairs
    - Accountants' report
    - Balance sheet
    - Profit and loss account
    - Relatively few notes
  - (b) Companies
    - Consolidated or sole entity
    - Size: determines whether auditors' report or accountants' report (optional)
    - Directors' report

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2. Types of financial statements (Continued)
  - (b) Companies (Continued)
    - Balance sheet
    - Profit and loss account
    - Cash flow statement
    - Notes to the financial statements

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- (a) Companies
- Auditors' report, accountants' report or no report
  - Contents of auditors' report
  - Acceptance by Companies' House
  - Revisions to past financial statements
  - Access to auditors'/accountants' working papers

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(Continued)**

- (b) General
- Acceptance by HM Revenue & Customs, correspondence and investigations
  - Correspondence on VAT and investigations
  - Regulatory returns

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FINANCIAL STATEMENTS**4. Some key issues**

- (a) Date of preparation and/or examination
- Requirements re filing at Companies House
  - Requirements re submitting returns to HM Revenue & Customs
- (b) Quality of presentation/disclosure
- Basic disclosure: page numbers and notes corresponding to financial statements
  - Consistency between financial statements and notes thereto
  - Omission of relevant notes

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- (c) Consistency within financial statements
- Stock/debtors and turnover
  - Trade creditors and cost of sales
  - Profits and cash flows
  - Borrowings and interest payable
- (d) Nature of business
- Stock in manufacturing businesses
  - Gross profit margins of travel businesses
  - Cash flows of retail businesses
  - Fixed assets of nursing home businesses

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**5. Balance sheets**

*31 December 2008*

	<u>£</u>	
<b>Fixed assets</b>		
Intangible assets	xxxx	
Tangible assets	xxxx	
Investments	<u>xxxx</u>	
	<u>xxxx</u>	
<b>Current assets</b>		
Stocks	xxxx	
Debtors	xxxx	
Cash at bank and in hand	<u>xxxx</u>	
	xxxx	
<b>Creditors: amounts falling due within one year</b>	<u>(xxxx)</u>	
<b>Net current assets</b>	<u>xxxx</u>	
<b>Total assets less current liabilities</b>	xxxx	
<b>Creditors: amounts falling due after more than one year</b>	(xxxx)	
<b>Provisions for liabilities and charges</b>	<u>(xxxx)</u>	
<b>Net assets</b>	<u>£xxxx</u>	

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**5. Balance sheets (Continued)**

*31 December 2008*

	<u>£</u>	
<b>Capital and reserves</b>		
Called-up share capital		xxxx
Revaluation reserve		xxxx
Profit and loss account		<u>xxxx</u>
<b>Shareholders' funds</b>		<u>£xxxx</u>

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**5. Balance sheets (Continued)**

(a) Indicator of financial health of the business

- Fixed assets
- Net current assets
- Net assets

(b) Fixed assets: varying importance according to type of business

- Intangible assets
- Land and buildings
- Plant and machinery
- Capitalised costs
- Investments

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**5. Balance sheets (Continued)**

(c) Current assets

- Importance of cash
  - availability;
  - reasons for big variations.
- Debtor collection
  - trade debtors;
  - money owed by directors.
- Stocks and work in progress
  - valued by directors or valuers;
  - work in progress.

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- (d) Current liabilities
- Creditor payment
    - trade creditors;
    - money owed to directors.
  - Bank loans
    - overdrafts;
    - term;
    - interest rates.

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- (e) Sources of funding of the business and timing of debt repayments
- Equity/debt
  - Future sources
  - Impact on profit and loss account

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	<i>Year ended 31 December 2008</i>
	<i>£</i>
Turnover	xxxx
Cost of sales	xxxx
<b>Gross profit</b>	xxxx
Overhead expenses	xxxx
<b>Operating profit</b>	xxxx
Finance costs	xxxx
<b>Profit before taxation</b>	xxxx
Taxation	xxxx
<b>Profit after taxation</b>	xxxx
Dividends	xxxx
<b>Retained profit</b>	xxxx

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- (a) Sustainability of profits
- Turnover
  - Gross profit and overheads
- (b) Trends in turnover and possible under-recording
- Normally excludes tax (VAT, duty)
  - Possible under-recording
    - cash businesses;
    - consistency from year to year;
    - consistency with other information.

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- (c) Trend of gross profit margins
- Effect of movements in stock and work in progress on profit
  - Consistency of margins from year to year
  - Consistency with industry norms
- (d) Overhead expenses
- Overall level and main elements: usually staff and premises
  - Expenses "put through the business" (e.g. travel, repairs and maintenance)
  - Fixed and variable

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- (e) Directors' remuneration
- (f) One-off and exceptional items
- Restructuring/reorganisation costs
  - Profit or loss on sale/reorganisation of operation
  - Profit or loss on disposal of fixed assets
- (g) Factors influencing tax charge
- Affected by one-off events
  - Disallowed expenses
- (h) Profits available for distribution
- Dividends/drawings
  - Retained profit

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- (a) Directors' report
- Principal activities
  - Directors and their shareholdings
- (b) Cash flow statements
- Inflows and outflows of funds
  - Short-term liquidity trends
  - Long-term ability to generate cash

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- (c) Importance of certain notes to financial statements
- Most notes expand on disclosure re balance sheet and profit and loss account
  - Accounting policies
  - Post-balance sheet events
  - Contingencies
  - Related party transactions
- (d) Profit forecasts and business plans

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