

Keeping it real

To meet their basic objective financial statements must be useful and the information relevant and reliable and a faithful representation.

Information will have relevance if it influences the decisions of the users. Irrelevant information has no use. Relevance and reliability or faithful representation are primary characteristics relating to content, together with the threshold quality and materiality. The primary characteristics relating to presentation include comparability, clarity and understandability. Such financial statements are based on accounting standards issued by the Financial Reporting Council (FRC), UK GAAP and their Financial Reporting Standards (FRSs) or those issued by the IASB, the International Accounting Standards Board, the International Financial Reporting Standards (IAS/IFRSs)

The IASB's (International Accounting Standards Board) The Conceptual Framework for Financial Reporting (issued 2015) and the UK GAAP Statement of Principles identify the major user groups of financial reports:

- Potential investors/shareholders.
- Employees.
- Lenders.
- Suppliers.
- Other trade creditors.
- Customers.
- Government.
- The public.

Of these, the IASB's Conceptual Framework identifies potential and existing investors, lenders and other creditors as the primary users. The others being interested parties to whom general purpose financial reports are directed and may also find such financial reports useful.

So, what are the needs of these groups and how would they use the published statements?

Potential investors/shareholders

This group would comprise of both existing and potential shareholders, who would be considering 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 terms of the share price rising). The investor group would also be interested in profitability and its trend over a period of time.

If the investor takes a short-term view, then current dividends are of interest; a long-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



these are based on current performance, company forward strategy is often included.

Carillion report: who read that?

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 employment opportunities.

They would be interested in both the current financial stability and the long-term financial viability of the business and would need information in a clear, simple and understandable form. I have seen some employee reports that include a value-added approach rather than a profit and loss account review 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 whether they will get their money back.

A short-term loan creditor will immediately consider cash flow. The Statement of Cash Flow, a section within Financial Reporting Standard, FRS 102 (UK GAAP); and for those companies

using International Financial Reporting Standards the Statement of Cash Flows, IAS7, will be of particular interest here. The banks make up much of this grouping and would also have an interest in the net realisable value (NRV) of the assets.

Medium- and long-term creditor groups will review the future cash flow potential of the business. They would have an interest in current and future profitability and growth prospects of the entity. A further consideration would be on the priority of claims on the business' resources.

Suppliers

This group comprises the trade creditors – an important element in the supply of a business' working capital. They would be interested in the financial stability of the business in terms of cash flow and its ability to meet its short-term liabilities. Suppliers 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; other trade creditors would have similar needs.

Customers

This group will be interested in the business' short- and long-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

Government departments require published financial information for the purposes of company taxation and VAT. The government is a decision-maker and its forward economic plans are influenced by the performance of all businesses within various sectors of the economy. Current financial reports will be used as a base in its economic models for assessing future performance.

The public

Businesses do not exist in isolation; they are part of society at large and as such generate much public interest, so the public are often referred to as 'stakeholders'.

At local and national level, factors such as employment and the environment are often key interests. Some of these issues may be included in a business' financial and long-term strategy.

Above we have referred to business in the form of companies. However, we should be aware that public sector bodies – such as local authorities and NHS trusts, together with non-profit-organisations and charities – publish financial statements that are also relevant to a wide range of user groups. **PQ**

Philip Dunn explains the importance of financial statements and who they are of most use to

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