Module 5: Financial documents
Unit 4: Revision

You have successfully finished Module 5. Well done! Now you can check how much you've remembered. ☺

READING

1) Which of the following 16 words would you expect to find in a short text defining the different financial statements?

balance	**bookkeeping**	**bookmarking**	**capital**
capitalist	**equilibrium**	**flow**	**liabilities**
limited liability	**overheads**	**overturn**	**pour**
reservations	**reserves**	**turnover**	**underground**

STUDY TIP
This is a different type of exercise from the previous ones. If you look at the words in the box and try to pick the ones you would **expect** in a text about financial documents, you are preparing your brain to focus on key vocabulary. It will help you understand the text better and learn new words more easily. ☺

Now read the text and underline the eight words you chose above:

Companies are required by law to give their shareholders certain financial information. Most companies include three financial documents in their annual reports.

The **profit and loss account (P & L account)** shows revenue and expenditure. It gives figures for total sales or turnover (the amount of business done by the company during the year), and for costs and overheads. The first figure should be greater than the second: there should generally be a profit – an excess of income over expenditure. Part of the profit is paid to the government in taxation, part is usually distributed to shareholders as a dividend, and part is retained by the company to finance further growth, to repay debts, to allow for future losses, and so on.

The **balance sheet** shows the financial situation of the company on a particular date, generally the last day of its financial year. It lists the company's assets, its liabilities and shareholders' funds. A business's assets consist of its cash investments and property (buildings, machines and so on), and debtors – amounts of money owed by customers for goods or services purchased on credit. Liabilities consist of all the money that a company will have to pay to someone else, such as taxes, debts, interest and mortgage payments, as well as money owed to suppliers for purchases made on credit, which are grouped together on the balance sheet as creditors.

The basic accounting equation, in accordance with the principle of double-entry bookkeeping, is that Assets = Liabilities + Owners' (or Shareholders') Equity. This can, of course, also be written as Assets – Liabilities = Equity. An alternative term for shareholders' equity is Net Assets. This includes share capital (money received from the issue of shares), sometimes share premium (money realized by selling shares at above their nominal value), and the company's reserves, including the year's retained profits. A company's market capitalization – the total value of its shares at any given moment, equal to the number of shares times their market price – is generally higher than shareholders' equity or net assets, because items such as goodwill are not recorded under net assets.

A third financial statement is the **cash flow statement**. As the name suggests, this statements shows the flow of cash in and out of the business between balance sheet dates. Sources of funds include trading profits, depreciation provisions, borrowing, the sale of assets and the issuing of shares. Applications of funds include the purchase of fixed or financial assets, the payment of dividends and the repayment of loans and, in a bad year, trading losses.

2) According to the text, are the following true (T) or false (F)?

1.	Company profits are generally divided three ways.	T/F
2.	Balance sheets show a company's financial situation on 31 december.	T/F
3.	The totals in balance sheets generally include sums of money that have not been paid.	T/F
4.	Assets are what you own; liabilities are what you owe.	T/F
5.	Ideally, managers would like financial statements to contain no items in brackets.	T/F
6.	Limited companies cannot make a loss because assets always equal shareholders'equity.	T/F
7.	A company's shares are often worth more than its assets.	T/F
8.	The two sides of a cash flow statement show trading profits and losses.	T/F
9.	Depreciation is a source rather than a use of funds.	T/F
10.	A consolidated account is a combination of a balance sheet and a profit and loss account.	T/F

KEY:

Exercise 1:

The most probable words are: balance, bookkeeping, capital, equilibrium, flow, liabilities, overheads, reserves, turnover.

Exercise 2:

1 True; 2 False; 3 True; 4 True; 5 False (if you don't have a debtors total, for example, you probably aren't doing any business); 6 False; 7 True; (this means the market price, of course, rather than the book price); 8 False; 9 True; 10 False