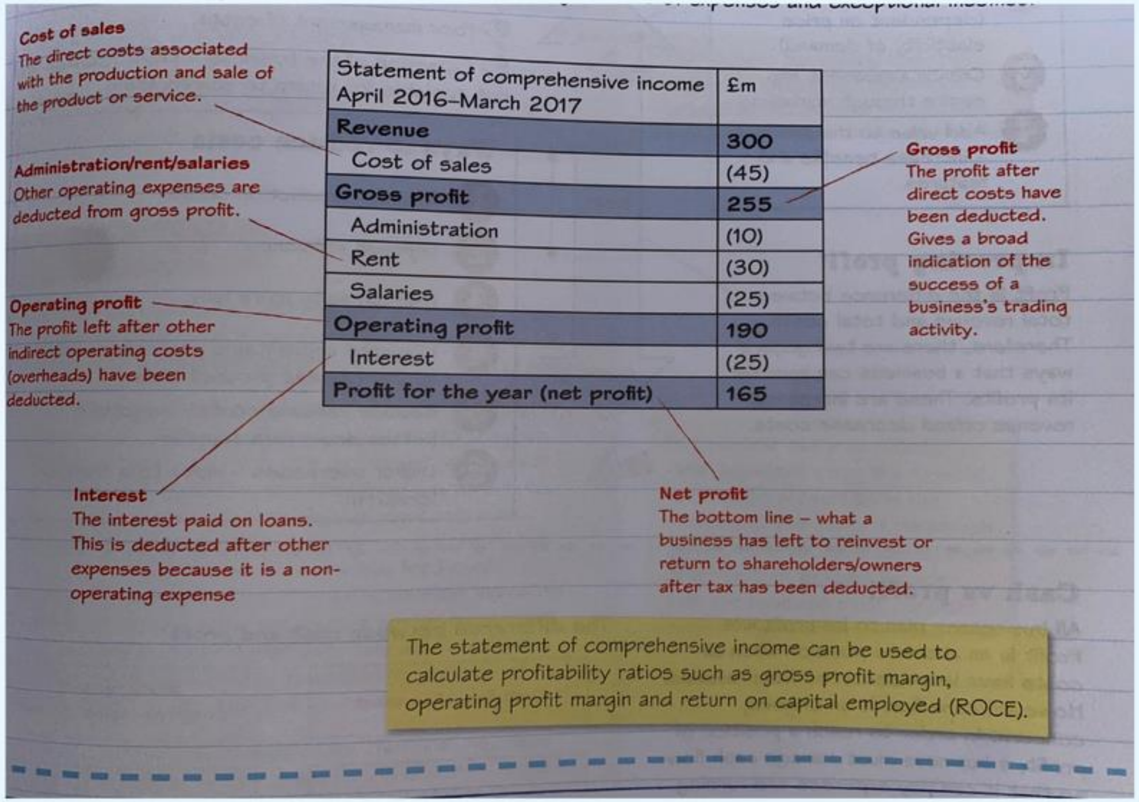
The Statement of comprehensive income

A business will produce a range of financial information to support its stakeholders in decision-making. Two key documents that all companies are required to produce are the statement of comprehensibve income and the balance sheet.

The Statement

The statement of comprehensive income at its most basic will communicate the revenue generated by a business and then its profit at various levels following a series of expenses and exeptional incomes



Cost of sales
The direct costs associated with the production and sale of the product or service.

Administration/rent/salaries
Other operating expenses are deducted from gross profit.

Operating profit
The profit left after other indirect operating costs (overheads) have been deducted.

Interest
The interest paid on loans. This is deducted after other expenses because it is a non-operating expense

Statement of comprehensive income April 2016–March 2017	£m
Revenue	**300**
Cost of sales	(45)
Gross profit	**255**
Administration	(10)
Rent	(30)
Salaries	(25)
Operating profit	**190**
Interest	(25)
Profit for the year (net profit)	**165**

Gross profit
The profit after direct costs have been deducted. Gives a broad indication of the success of a business's trading activity.

Net profit
The bottom line – what a business has left to reinvest or return to shareholders/owners after tax has been deducted.

The statement of comprehensive income can be used to calculate profitability ratios such as gross profit margin, operating profit margin and return on capital employed (ROCE).

What you can find from the statement :

- Changes in sales revenue
- chanes is the direct costs of sales
- how well a business is managing its operating costs
- the profitability of a business
- Unusual incomes/expenses during the year

Improving Profitabilitiy

Ways to increase revenue

1. Increase Prices
2. Reduce Process
3. Create awareness and desire through marketing
4. add value to the product - increase benefits and features.

Improving Profit

Profit is the difference between total revenue and total costs. Therefore, there are two geberal ways that a business can improve its profits. These are increased revenue or/and decrease costs

Why businesses are unprofitable

There are a number of reasons why a businessmight be unprofitable

1. No demand for the product
2. Selling at the wrong price
3. Low contribution per unit
4. Poor management of costs
5. Expansion of the business - profit retained and not availabe for retuurn to shareholders

Profitability can be improved through measures taken by each functional area of the business

Difference between cash and profit

Cash flow statement	Statement of comprehensive income
cash inflows	Revenue earned
-cash outflows	-expenses incurred
= net cash flow	= net profit (loss)

Ways to reduce costs

1. Reduce production costs
2. Improve efficiency
3. Use capacity more fully
4. Eliminate unprofitable processes- such as unprofitable product lines
5. Reduce variable costs- negotiate better deals with suppliers
6. Lower overheads - move to a cheaper location

Cash Vs Profit

All bsuinesses plan to be profitable. Profit is an absolute position when all costs have been deducted from revenue. However, cash flow is an ongoing concern. In order to reach a position or profit, a business must manage cash flow so that it can pay expenses and running costs . Theproblem with managing cash is that business expenses are often incurred before revenue is generated or received. A buisness cannot be profitable unless it can effectivley manage its cash flow. This is a question of timing and can be crucial to business success

Statement of Financial Position (Balance Sheet)

The balance sheet

A balance sheets a financial document thst records the assets and liabilities of a business. A balance sheet gives a snapshot of the value and finacial strentgh of a business

Non current assets
Also known as fixed assets, non-current assets are used to operate the business and include land and machinery (tangible or fixed assets) and brands and patents (intangible).

Current assets
Assets that the business expects to use or sell within the year. These can be converted into cash to pay off liabilities.

Net current assets
Current assets – current liabilities = the working capital a business has available.

Net assets
Total assets – total liabilities = the value of a business.

Balance sheet as at 31st March 2015		£m
Non-current assets		70
Intangible non-current assets	10	
Tangible non-current assets	60	
Current assets		55
Inventories	30	
Debtors	25	
Current liabilities		(35)
Creditors	(30)	
Interest	(5)	
Net current assets		20
Non-current liabilities		(50)
Long-term loan	50	
Net assets		40
Total equity		40
Share capital	30	
Reserves	10	

Current liabilities
Payments due within 1 year.

Non-current liabilities
Debts that a business does not expect to pay within a year.

Total equity
Will always balance with net assets – it represents how a business has been financed.

A balance sheet can be used to calculate financial ratios such as liquidity ratios, gearing ratios and efficiency ratios.

What we can find out from a balance sheet:

- The value of a business
- The current assets a business holds
- Short term liabilities the business will need to pay within the year
- The liquidity of a business
- The long term debts of a business
- How a business has be financed

Current Ratio

The current ratio is a key liquidity ratio. It compares current assets with current liabilities. In doing so it assesses whether a business has sufficient working capital to pay its short term debts.

Calculated by:
Current assets/ current liabilities

Acid test Ratio

The acid test ratio is considered a more severe measure of liquidity. This is because it does not take into account the inventories of a business. This is because for many businesses there is no guarantee that inventories can be quickly turned into cash.

Calculated by:
Current assets - inventories / current liabilities

LIQUIDITY

Liquidity refers to the ability of a business to pay its debts and liabilities in cash when they fall due. Th concept of liquidityis closely linked to cash flow management. Cash is the most liquid asset (current asset) that a business has and any business would quickly fail if it ran out of cash.

Working capital

Working capital is the money within a business that is needed to pay for the day to day running costs. This includes paying bills , wages, and purchasing stock. Working capital can be calculated from the information contained in a balance sheet. Working capital is slightly different from cash as it takes intoaccount other current assets. However, other current assets such as stock and debtors cannot easily be used to pay expenses. This is why cash is the most important asset when assessing the liquidity of a business.

Ways to improve Liquidity

Encourage cash sales

Negotiate additional short term loans

Encourage early settlement of debts

Use an overdraft facility

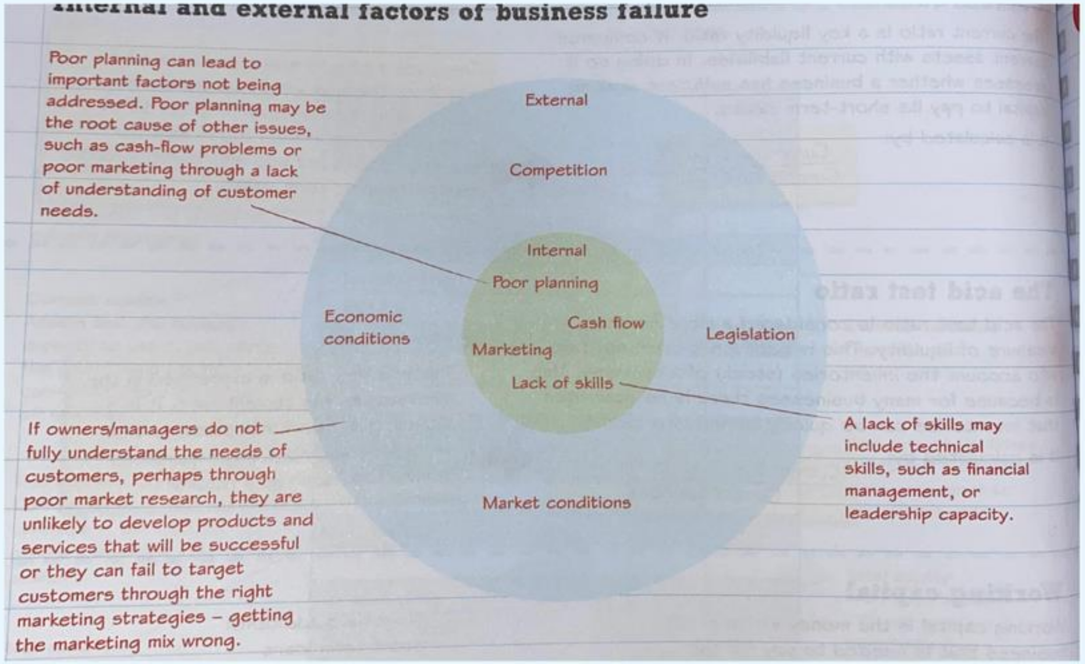
Delay payments

Sell off current assets

Take out credit aggreements with suppliers

Business Failure

Businessses may fail for a number of different reasons. Some of these reasons are due to poor management of the business. However, there may be unforeseen circumstances and external forces that are hard for the owner to plan for,



Causes of cash flow problems

Allowing too much trade credit to customers

Overtrading

Poor credit control- not chasing debts and ensuring customer pay on time

Unforeseen costs - not accounted for in cash flow forecasting

Innacurate cash flow management - poor research or lack of any cash flow management

External Factors for Failures

External factors for a business failure are often hard to predict and can be beyond the control of the business

- Competition - a new competitor in the market can lead to a shortage of demand and falling sales
- Legislation - new legislation can often mean increased costs as a business adjusts its products and process to comply
- Market conditions- for example, changes in commodity prices or consumer tastes
- Economic factors.