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OUR GUIDE TO STATEMENT OF CHANGES IN EQUITY

Introduction

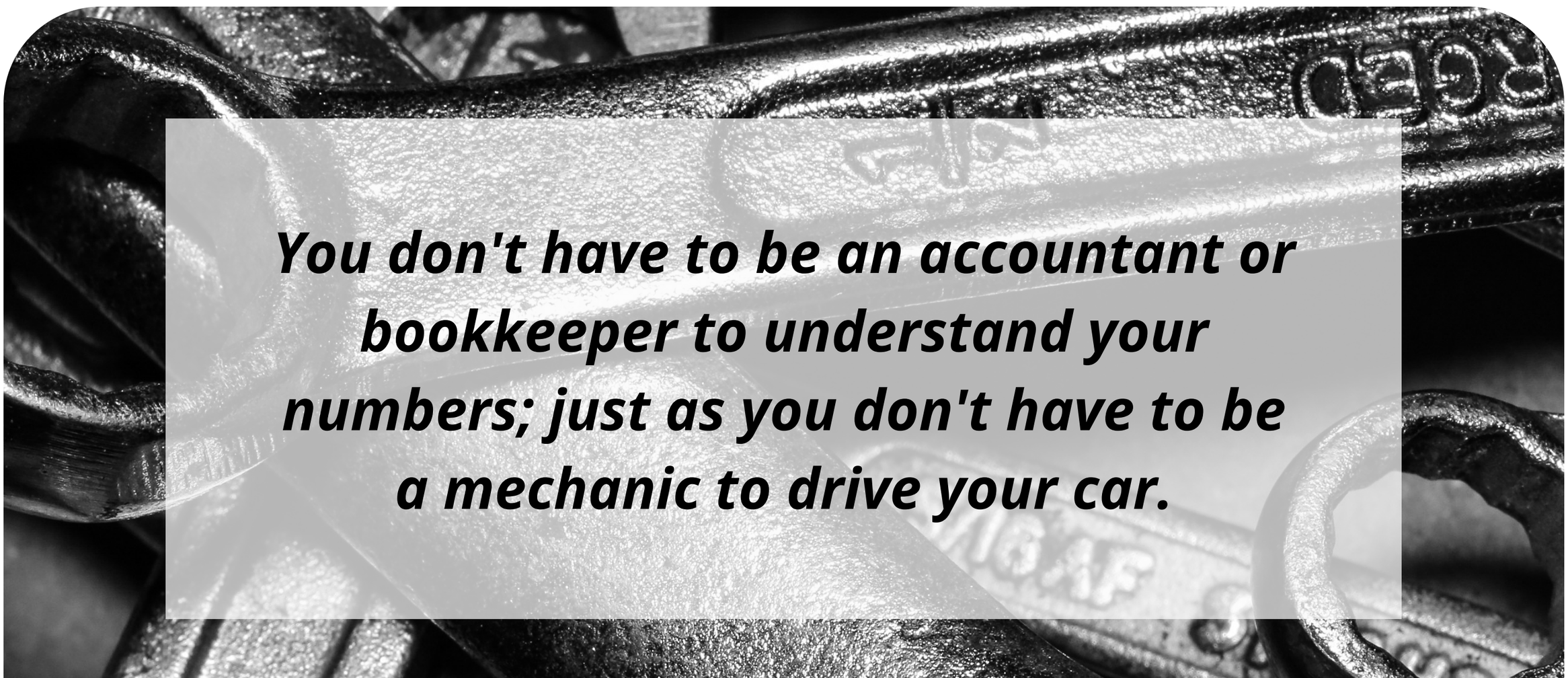
Your financial reports tell you the story of your business; allowing you to interpret the results of your business activity. The better you understand your financial reports, the better your decision-making and results will be.

We want to share the benefits of understanding your numbers, give you an overview of the standard reports and provide helpful tips on using them to improve your business. Where possible, we've avoided jargon and 'Accountanese'.

However, this guide is no substitute for specific one on one advice. We are available to talk to you about your unique situation and how we can help you and your business.

The benefits of knowing your numbers:

- Understand if your business is growing or shrinking
- Identify and track trends
- Compare results to your expectations (as set in your budget)
- Compare results between years or different periods
- Identify areas of strengths and weakness
- Measure your business efficiency
- Measure the value of your business
- Identify symptoms of underlying problems
- Measure your cashflow
- Make better business decisons



Tips for beginners

No matter which report you're looking at, there are fundamentals to consider and understand:

1. Is the data 'clean'? Most software packages allow you to export your own reports. While this gives you flexibility, the data can be unreliable if transactions haven't been coded correctly or bank statements haven't been reconciled. Likewise, if monthly invoicing hasn't been completed, sales reports could be understated. Contact us for information on the monthly procedures you should follow to keep your data 'clean'.

2. Inspect what you expect. Your reports are a representation of what you planned for your business. For example, you may have set a sales or gross profit target in your Business Plan and Cashflow Forecast (what you expected). Your reports can then be used to inspect if you're on track to achieve those targets.

3. Know which reports to use. Profit & Loss Statements measure income and expenses; the Balance Sheet measures assets, liabilities and net worth. There are different versions of each report, e.g. for the Profit & Loss you can measure this year vs last year, this period vs the same period last year, or this period vs the budget you set. Talk to us about the most appropriate reports for your business.

Tips for beginners cont.

4. Go horizontal and vertical when analysing your financial reports. A horizontal analysis compares the results of previous periods, e.g. comparing your 2020 Gross Profit to your 2019 Gross Profit. This shows whether your results are improving over a specified period. A vertical analysis calculates each item in the statement as a percentage of a base item, e.g. calculating expenses as a percentage of sales in your Profit & Loss. Conducting both helps identify specific areas of potential improvement.

5. 'As at' or 'for the period ending'. An 'as at' report shows the balances at the end of a specific period, e.g. the Balance Sheet shows asset and liability balances at the end of the financial year. A 'for the period ending' report shows the results over a period of time, e.g. the Profit & Loss shows your Gross Profit or Net Profit over the specified period.

6. Choosing the date range. For a period ending report, ensure you correctly specify the start and end date for the period you want to measure. For example, reporting on the current month and the year to date (the period from the start of this current financial year to the date required). It's best practice to choose a date that is a month end date, e.g. if you want to print a report on 15 July, set the date range to end on 30 June, as you should have all income and expenses coded and reconciled for the period ending 30 June, but may not have coded and reconciled them for July yet. Not to mention reoccurring monthly expenses may not be included if using a mid-month date.

Your key financial reports

The rest of this guide provides an overview of your key financial reports, what each report tells you about your business, some key ratios to use to track your results, and some tips on how to make good use of the reports.

Key ratios:
By calculating key ratios, you can compare your results over a number of periods, compare the profitability of different product lines, divisions or locations, and compare your results to your industry benchmarks.

All of this provides information which should be used in your decision-making. It’s important to only compare your ratios with companies in the same industry; what may be viewed as a 'good' ratio for one industry, may be 'poor' in another.

Below is an overview of Statement of Changes in Equity.

To ensure you have a rounded view and understanding of your business numbers, we recommend you also look at the following reports:

1. Your Trading Account.
2. Statement of Profit & Loss.
3. Balance Sheet.
4. Shareholder Current Account.

Statement of changes in equity

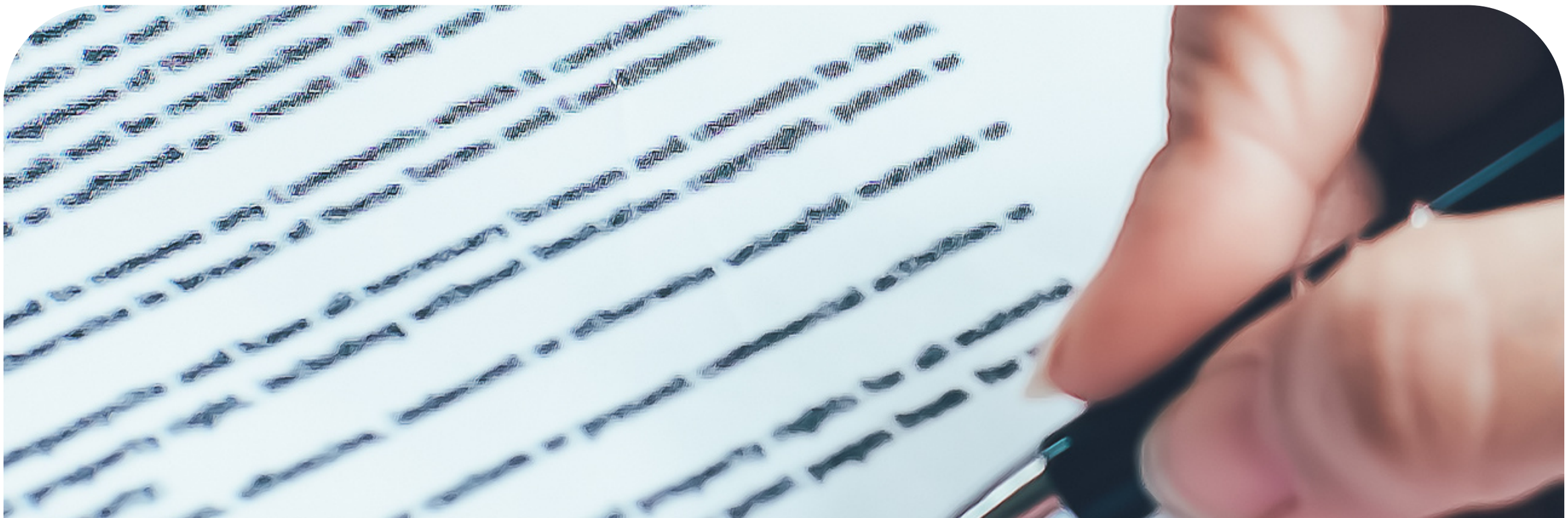
The Statement of Changes in Equity records what happens to any profits for the year; whether they are paid out as dividends or kept in the business as retained earnings. Generally speaking, the higher the equity, the better for the company. However, shareholder loans can also be treated as part of the equity.

Therefore, it's possible that, while the company is technically insolvent (more liabilities than assets), if the shareholder loans are recorded as equity, the company is effectively relying on the shareholders to pay its debts as they fall due.

The basic format for your Statement of Changes in Equity is:
Total Equity = Opening Balance + Revaluation Reserve + Profit - Dividends Paid - Loss

Descriptions:
Opening Balance: The equity position from the end of the last financial year.
Revaluation Reserve: A reserve created by the regular revaluation of assets, which cannot be accounted for as realised profit and therefore is not distributable as a dividend.
Profit for the Period: Carried forward from your Statement of Profit & Loss.
Dividends Paid: Any dividends paid out to shareholders during the year.
Loss for the Period: Carried forward from your Statement of Profit & Loss.
Total Equity: The equity position at the end of the period.

If Total Equity is negative, the company is insolvent and cannot pay out any dividends. The directors must take action to increase the profitability of the company.



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"If you'd like to learn more about your financial reports, the key financial ratios you should be measuring, and how to improve your results, get in touch to find out how we can help."

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