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Introduction

'Accountancy is the art of recording, classifying and summarising in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the result thereof' AICPA 1961.

The Accounting Equation

The first step to take in understanding accountancy/financial reports is to be able to understand the accounting equation. This is because the whole of Financial Accounting is based upon the idea/concept of the Accounting Equation. It can be explained by saying that, if a firm/company was set up or is to be set up and start trading, then it needs resources, such as capital. The accounting equation is shortened with the following formula; **Assets = Capital + Liabilities** I will now explain each of the terms involved in the formula.

Capital

There are three meanings/definitions usually associated with this accountancy term. The first definition states that Capital represents the amount of money invested/resources supplied by the owner(s) in the business. The second meaning given to capital states; that Capital represents the amount of money owed by the business to the owner(s). The next definition may help when understanding the worth ability of CRH, it states; Capital is a current estimation of the business/firm/company's overall value/worth as is sometimes referred to as Net Worth, for example if a business had €1000 worth of assets and €300 in liabilities, then its overall net worth would be €700.

In relation to CRH, if we look at both their Group Balance Sheet and Company Balance Sheet, we can see that their main sources of Capital come from their Equity Share Capital, Profit And Loss A/c and their Share Premium Account. I will explain each later in the report.

Assets

These are often described as the resources available within the business, which are of value and are owned by the business. Assets are usually divided into two categories, which include Fixed Assets and Current assets. Fixed Assets vary but can include the following; Buildings, Land and Machinery/Equipment, they are usually not intended for resale, they are depreciated over time as they are used, land is the only fixed asset which may not lose its value over time.

With relation to CRH, if we look at both their Group Balance Sheet and Company Balance Sheet, we can see that their main sources of Fixed Assets are their Tangible Assets and their Financial Assets.

Current Assets are defined as assets, which are expected to be transformed (usually one year) into cash. They include stocks such as materials, supplies, work in progress, finished goods and debtors. CRH's main sources of Current Assets include; stocks, debtors and their bank/cash a/c. Each of these will be explained under the balance sheet.

Liabilities

These are classified as the sums of money/resources owed by the business to other businesses, firm's and people. They are usually divided into two categories; they include Long - Term Liabilities and Short-Term Liabilities. Long Term Liabilities are usually liabilities, which are not due for repayment in the current year. Short-Term Liabilities are the due amounts, which are owed by the business, which fall due for repayment within one year. Most firms/businesses find it easier to buy goods and maintain services (electricity, gas etc.) on credit, which in turn gives rise to the term Creditors.

The reason why amounts of money owed to creditors are known as liabilities is because the business is liable to them for the amounts owed. If we look at CRH's Balance Sheet again we will find that their main sources of liabilities are as follows, Bank Loans and Overdrafts, Trade Creditors, Corporation Tax and Dividends Proposed each of these will be explained in more detail in the Balance Sheet section.

I will now describe the main elements involved in the following financial statements; The P+L, Balance Sheet, and Cash Flow statement. Each element will be described and any relevance it may hold to accounting standards and under company law will be mentioned.

The Profit And Loss Account

The measurement of profit is probably the most important function of financial accounting. Investors, managers, bankers and others are interested in knowing how well a business is doing. The profit and loss account shows the results of the flow of activity and transactions and is designed to report the profit performance of a business for a specific period of time. Profit represents the difference between revenues and expenses. The p+l reports for a specific period of time the items that compromise the total revenue and total expense and the resulting net profit.

The companies' act provides two horizontal and two vertical formats for the presentation of the profit and loss account. Essentially, the two formats may be distinguished by the way in which costs are analysed. **Format 1** analyses cost by type of operation while **Format 2** analyses costs by type of expenditure. CRH have adopted Format 1. I will describe each element of the profit and loss account for CRH as it appears respectively in the account.

Turnover

This is described as any amount derived by the company from the sales/provision of goods and services. This term is also referred to as sales, which it replaced. It includes all receipts from these activities after deduction of traded discounts, and value added tax.

Cost Of Sales

In calculating the cost of sales, distribution (cost to move goods/services) and administrative expenses, all directors' fees, provisions for depreciation, employee costs, and lease payment for machinery or plant (factory) must all be accounted for. Thus the final figure you get is your Cost Of Sales.

Gross Profit

This is calculated by subtracting the cost of sales figure from the turnover figure. And is defined as the excess of sales over the cost of goods sold in any accounting period (year).

Other Operating Income

This includes profits/income from normal operating activities, which does not fall under any other headings, for example royalties and rent received.

Other Investment Income

The companies act requires that income from other fixed -asset investments and other interest receivable and similar income to be shown separately and must be identified in the notes or if not in the P+L account.

Interests Payable And Similar Charges

This element includes bank loans, overdrafts and any other loans made to the company which are either repayable other than by instalment and fall due for repayment within 5 years.

Profit On Disposable Of Fixed Assets

This figure is ascertained from the sale of a fixed asset such as land, buildings etc.

Profit On Ordinary Activities Before Taxation

This is described the profit retained on income before taxation.

Taxation

The requirements of the companies act are two fold, first, the profit and loss account must disclose the net profit or loss on ordinary activities before taxation, and the taxation charge on those activities should be deducted to give the net profit or loss on ordinary activities after taxation. The guidelines on how to deal with cash are set out in the accounting standard SSAP 15.

Profits Retained For The Financial Year

This figure represents the overall profit in which the company has made in the financial year.

The Balance Sheet

The balance sheet is an ordered list of the Assets, Liabilities and Capital of a business. It is usually drawn up at the end of the trading year. It does not measure the ongoing performance of the business, but is a 'snapshot' of their current financial position revealing both assets and liabilities, along with the owners' equity. Though the balance sheet is a snapshot and business is fluid, today's numbers/figures will have changed by tomorrow. But, the change should not be significant enough to cloud the fiscal picture (company performance) that's being presented. Lending institutions and businesses alike rely on balance sheets to determine the credit worthiness of an enterprise, to assess its ability to cover both current and future debts.

The Companies Act provides two formats for the balance sheet presentations, one vertical the other horizontal. Once a company has chosen which format it intends to adopt, it may not alter that choice without giving notice to shareholders in a note to that account. If we look at the balance sheet layout of CRH, we can see that it follows the vertical format otherwise known as **Format 1**.

If we now look at the balance sheet provided by CRH end of year accounts, I will be able to give you an insight into the meanings and implications of the financial statements made or put into the balance sheet starting from top to bottom.

Fixed Assets

As mentioned earlier in the section on the Accounting Equation, fixed assets are generally long-term assets in the business which are not really intended for resale. They include tangible assets such as buildings, land, machinery etc. (assets which have a long life span and are physical in form) and Intangible Assets. Under the Companies Act fixed assets are subject to any provision for depreciation or reduction in value and are to be shown at purchase price or production cost.

Intangible Asset

This is the first fixed asset we can see listed in the CRH's balance sheet. Intangible assets do not have any physical features unlike any other type of fixed asset. Instead they represent

legal rights and relationships beneficial to the owner(s). Intangible assets are very hard to measure in value and future benefits they may obtain. Examples of intangible assets include patents, trademarks, research and development, and **Goodwill**.

Goodwill

Goodwill may be described as the sum of the intangible attributes of a business, which contribute to its success. These can vary from a favourable location, good reputation, the ability and skill of staff and management, and its relationship with creditors, suppliers, and customers. It is quite hard to measure goodwill in value and this is why it is generally excluded from the books of the balance sheet. Under FRS 10 Purchased goodwill should be capitalised and amortised (paid off), usually over a period not exceeding 20 years. Provision is made for the useful life to be extended beyond 20 years when circumstances justify this, and even for the useful life to be taken to be indefinite, so that there is no amortisation (paying off) at all. The Companies Act 1985 requires all assets with a finite life to be depreciated.

Current Assets

As mentioned earlier current assets are assets, which are expected to be transformed into cash within one year. I will now explain some of the current assets that are in the CRH balance sheet. Under the companies act the value to be placed on any current asset is the lower of the purchase price or production cost and the net realisable value (N.R.V.).

Stocks

Proper valuation of stocks is seen as essential when it comes to guaranteeing the accuracy of the profit figure and the balance sheet total, this is why we must value stock at its net realisable value (N.R.V.) and do stock taking to ensure accounts are not wrongly calculated because wrongly calculated stock is wrongly calculated profit. The Net Realisation Value is defined as the actual or estimated selling price of stock less all further costs to completion and the cost of marketing, distributing and selling the finished stock. Stocks may be valued using any of the recognised valuation methods including LIFO (Last In, First Out), FIFO (First In, First Out) and weighted average cost. Under the companies act stocks should be divided into the following categories; raw materials and consumables, work in progress, finished goods and payments on account. The accounting standard SSAP does not recommend the use of LIFO.

Debtors

Debtors are described as customers whom the firm has supplied goods on credit, and who now owe the money to the business. Debtors are seen as an asset because they represent a future inflow of cash into the business. Under the companies act debtors must be disclosed as the main heading on the balance sheet and the following items must be disclosed either on the balance sheet or in the notes thereafter they include; trade debtors, prepayments, called up share capital not paid, prepayments and accrued income. The amounts falling due after more than one year must also be shown separately for each item.

Cash, Short Term Deposits and Liquid Resources

These are seen as the most liquid of assets held by the company/firm, what this means is that they are directly transferable into cash. Under the companies act any assets that are more liquid must be listed last under the current assets heading. The value of cash or liquid assets is measured by the amount of cash/liquid assets held by the firm/business in their premises or in their bank account at the date of the balance sheet. Under both FRS 10 and FRS 11 stocks valued in cash must be separated in the balance sheet.

Creditors

Creditors are described as businesses/institution's with whom money and resources are owed to by the firm within one year and also referred to as a current liability. Under the companies act each type of creditor must be put into its own subheading and the amounts falling due after more than one year must be shown separately for each item. If we look at CRH balance sheet we can see that their main creditors include; Bank Overdraft, Trade Creditors, Corporation Tax and Dividends Proposed.

Bank Overdraft/Loan

A firm/company may borrow money from a bank by means of a bank overdraft. This means that the firm is allowed to pay more out of its bank account than it actually hold. When a bank account becomes overdrawn the firm owes money to the bank, the account becomes a liability and the balance becomes a credit one. Unlike a bank overdraft a loan generally does not fall within one year and usually supplemented with interest which is paid in the P+L account.

Corporation Tax

This is described to as the amount of money in which the firm owes in VAT (value added tax) on all goods and services it sell/provides within the tax year. This item is much better discussed in the profit and loss section.

Dividends Proposed

A shareholder of a limited company obtains their 'reward' in the form of a share of the profits, this is known as a dividend. The directors of the company must consider the amount of profits and decide on the amount of profits, which will be placed in reserves. Under the guidelines of the accounting standards FRS 14 and FRS 4, These state that earnings should be taken as the net profit or loss for the period after deducting dividends and any other seizure of profit in respect of non-equity shares.

Provisions For Liabilities and Charges

The companies act defines the provision for liabilities and charges as 'an amount retained as reasonably necessary for the purpose of providing for any liability or loss which is either likely to incurred (sustained) or likely to be incurred by the business, but uncertain to the date of incurrence and how much. To better describe this account would to call it the rainy day account for future loss or liabilities. This is described along with other contingencies and provisions under the accounting standard FRS 12.

Shared Capital

The capital of a limited company is known as its Share Capital. The type of capital in which CRH has issued is defined as **Called Up Share Capital**. When a company issues shares, it may not require immediate payment of all the money due and may call -up only the amount that is needed for its immediate needs. For example if CRH issued shares at €1.00 it may decide to only call up only €0.70c per share (shareholders pay this amount now) and call up the remaining €0.30c when it needs to).

Profit and Loss Account

This is the figure that most calculated in the profit and loss account it appears here as either a net profit or a net loss. Refer to the profit and loss account section.

Cash Flow Statement

The purpose of the cash flow statement is to show what cash has been generated by a business's operations and where the cash has gone. A cash flow statement classifies the sources and uses of cash flow from several types of business activities. These business activities are operating activities, returns of investment and servicing of finance, taxation, capital expenditure and financing activities.

Operating Activities

Profit/Loss for doing the following arrives at operating activities, net profit plus interest paid less interest and dividends received. This is how CRH managed to get their figure for their operating activities.

Returns on investments and servicing of finance

An investment is when a person invests money into an entity, with the view to making or losing money on it. The return (the money that you get back) on an investment can be either a profit (good) or a loss (bad). An example of an investment would be buying shares in a company. An example of a good return on this type of investment is receiving a high dividend rate (getting more money back than you put in, this can also be called interest received).

Sometimes a company needs an introduction of money into their business. An introduction of money is provided by financial services. A financial service is an establishment that gives out money with regard to certain terms and conditions. An example of a financial service provider is a bank. As with everything in life, nothing comes free. Financial services expect a return from their investment in you. This return is usually a percentage of the amount of money they have given you to be paid back over a number of years. This percentage can also be called interest paid.

Taxation

These are cash flows to (money coming from your pocket) and from (money being put into your pocket) taxation authorities (an organisation that follows a protocol in the method of calculating tax).

Capital Expenditure

These are cash flows associated with the acquisition (buying) and disposal (getting rid of) fixed assets (a long term asset e.g. buildings/machinery).

Financing Activities

These comprise of receipts from, or repayments to external providers of finance. (See servicing of finance).

Importance of Cash Flow Statements

Cash flow is the lifeblood of a business. A healthy cash flow is fundamental to a business's ability to survive and prosper. Managers use cash flow statements to avoid liquidity (the ability to pay day to day running expenses on time) problems. Thus cash flow statements say a lot about a company, they can enlighten you when it comes to interpreting whether it is economically viable to invest your hard earned cash. If cash flow is bad, it does not say a lot for the company.

Net Cash Inflow From Operating Activities

The net cash inflow from operating activities is the cash generated from the day -to-day operations (providing a service or the sale of goods) of the business.

Dividends Received from Joint Ventures

Shareholders are paid dividends. Dividends are a shareholders return on investment. In this case the investment is a joint venture. A joint venture is when two or more people investment their money into an entity that they deem worthwhile.

FRS 1

The Accounting Standards Board issued F.R.S. 1 in 1991; it deals with cash flow statements. The standard states that the cash flow statement should improve the understanding of a company's 'cash generating' and provide a basis for the assessment of a future cash flow'. What this means is that every medium to large sized company including CRH must provide a cash flow statement based on the ASB standard.

Relationship Of P+L, Balance Sheet and Cash Flow Statements

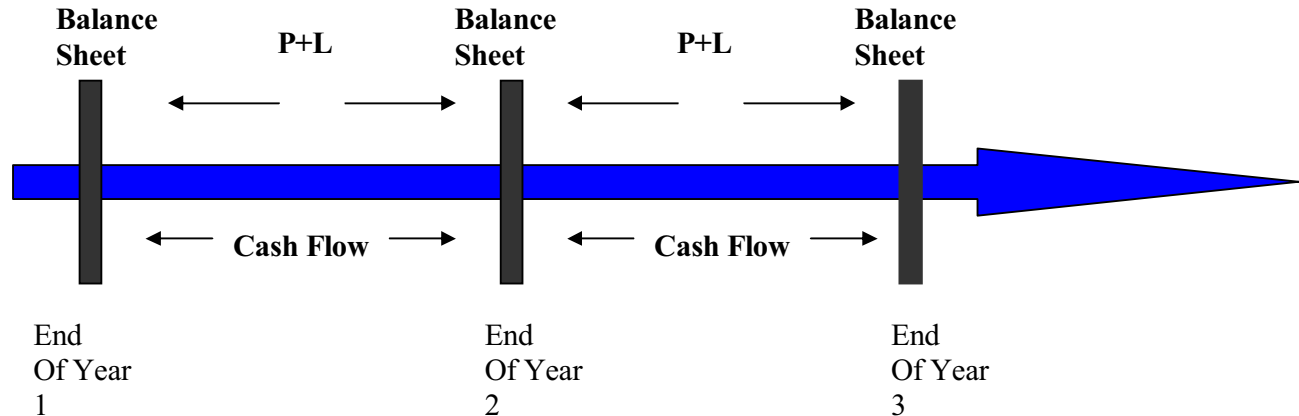
To conclude this report I will now give you by use of diagrams a view of the relationship between each of the financial statements.

Financial Document

Profit And Loss Account
Balance Sheet
Cash Flow Statement

Responsible For

Sales and Costs
Assets and Liabilities
Cash Inflow and Outflow



Bibliography