

Legal Business Solutions Academy: Accounting for lawyers

September 2023



Accounting for lawyers

This session aims to introduce the basics of accounting and bookkeeping.

In this interactive session, we will:

- share the purpose and background of accounting and the different Accounting Frameworks;
- introduce the primary statements in a typical financial statement; and
- introduce the concept of distribution and distributable reserves.

Throughout the session, we propose to educate, discuss and learn by way of going through different examples and discussions in a collaborative and interactive manner - so please ask questions and share any relevant experiences.



A bit about us



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Interactive session 1

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Agenda

- 1 Basic accounting background
- 2 Introduction to the primary financial statements
- 3 Dividend and reserves

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Basic
accounting background



Accounting

Purpose

- Accounting is a term that describes the process of presenting financial information to make it clear and understandable for all stakeholders and shareholders.
- To record and report a company's financial transactions, financial performance, and cash flows.
- To ensure statutory compliance.
- To evaluate the business performance
- To determine what can be distributed



Types of accounting standards

- **Generally Accepted Accounting Principles (GAAP)**
Governed by local accounting body (e.g in the UK this will be Financial Reporting Council - FRC).
A set of principles that companies in the jurisdiction follow when preparing their annual financial statements.
- **International Financial Reporting Standards (IFRS)**
The IFRS is a set of standards developed by the International Accounting Standards Board (IASB).



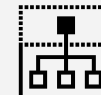
Users of accounting information

- Internally - business owners, managers, employees.
- Externally - creditors, banks, investors, unions, government and regulatory agencies.



Importance of accounting standards

- Consistency.
- Transparency.
- Easily comparable.
- Quality.



Accounting standards for UK entities

Types of business entity

Private companies

Public companies

Unlimited companies

Accounting standards

FRS 102/FRS 101/IFRS



Accrual accounting vs Cash accounting

Accrual accounting

Depicts the effects of transactions and other events and circumstances on a reporting entity's economic resources (assets) and claims (liabilities) in the periods in which those effects occur, even if the resulting cash receipts and payments occur in a different period.

Gives a more accurate view of finances
Conforms with GAAP guidance

Cash accounting

Depicts the effects of transactions and other events and circumstances on a reporting entity's actual cash transactions only.

Gives a shorter term view of finances
Can be utilised in management accounts
A simpler method of accounting (preferred by some smaller businesses)



2

Introduction to the primary accounts



What are the key elements of a financial statements?



Statement of financial position (Balance Sheet)

01



Statement of income and expense (Profit and loss account)

02



Statement of cash flows (Cash flow statement)

03



Statement of changes in equity

04



Notes to the accounts

05

Consolidated accounts vs Entity level accounts

Consolidated

A consolidated statement reports a company's financial performance on the whole

Intercompany positions are eliminated

Offers a comprehensive picture of the performance of a company including its subsidiaries and holding companies.

Entity level (Standalone)

A standalone statement represents a company's financial performance as a single entity

Offer details of the financial performance of that particular company

To be utilised when determining the distribution capacity of an entity

Statement of financial position (Balance Sheet)

Consolidated balance sheet ¹⁻⁵

| | Notes | 2022 CU'000 | 2021 Restated * CU'000 | 1 January 2021 Restated ^{4b} CU'000 |
|--|----------|----------------|------------------------------|--|
| ASSETS | | | | |
| Non-current assets | | | | |
| Property, plant and equipment | 8(a) | 128,890 | 102,080 | 93,145 |
| Right-of-use assets ^{11,12} | 8(b) | 9,756 | 9,508 | 7,708 |
| Investment properties | 8(c) | 13,300 | 10,050 | 8,205 |
| Intangible assets | 8(d) | 24,550 | 20,945 | 20,910 |
| Deferred tax assets | 8(e) | 7,849 | 5,524 | 4,237 |
| Other assets | 3(b) | 312 | 520 | - |
| Investments accounted for using the equity method | 16(e) | 3,775 | 3,275 | 3,025 |
| Financial assets at fair value through other comprehensive income ⁸⁻⁹ | 7(c) | 6,782 | 7,148 | 8,397 |
| Financial asset at fair value through profit or loss ⁸⁻⁹ | 7(d) | 2,390 | 980 | - |
| Financial assets at amortised cost ⁸⁻⁹ | 7(b) | 3,496 | 2,629 | 6,004 |
| Derivative financial instruments | 12(a) | 308 | 712 | - |
| Total non-current assets | | 201,408 | 163,371 | 151,631 |
| Current assets | | | | |
| Inventories | 8(f) | 22,153 | 19,672 | 18,616 |
| Other current assets | 8(g) | 491 | 428 | 419 |
| Contract assets ¹⁰ | 3(b) | 1,519 | 2,561 | 1,867 |
| Trade receivables | 7(a) | 15,662 | 8,220 | 5,123 |
| Other financial assets at amortised cost ⁸⁻⁹ | 7(b) | 1,100 | 842 | 783 |
| Derivative financial instruments | 12(a) | 1,854 | 1,417 | 156 |
| Financial assets at fair value through profit or loss | 7(d) | 11,300 | 10,915 | 10,370 |
| Cash and cash equivalents (excluding bank overdrafts) | 7(e) | 55,083 | 30,299 | 25,193 |
| | | 109,162 | 74,354 | 62,527 |
| Assets classified as held for sale | 8(g), 15 | 250 | 4,955 | - |
| Total current assets | | 109,412 | 79,309 | 62,527 |
| Total assets | | 310,820 | 242,680 | 214,158 |

* See note 11(b) for details regarding the restatement as a result of an error.

| | Notes | 2022 CU'000 | 2021 Restated * CU'000 | 1 January 2021 Restated ^{4b} CU'000 |
|---|-------|----------------|------------------------------|--|
| LIABILITIES | | | | |
| Non-current liabilities | | | | |
| Borrowings | 7(g) | 89,115 | 76,600 | 75,807 |
| Lease liabilities ¹¹ | 8(b) | 8,493 | 8,514 | 7,389 |
| Deferred tax liabilities | 8(e) | 12,456 | 6,820 | 4,355 |
| Employee benefit obligations ⁷ | 8(h) | 6,749 | 4,881 | 4,032 |
| Provisions | 8(i) | 1,573 | 1,382 | 1,304 |
| Total non-current liabilities | | 118,386 | 98,197 | 92,887 |
| Current liabilities | | | | |
| Trade and other payables | 7(f) | 15,760 | 11,723 | 13,004 |
| Contract liabilities ¹⁴ | 3(b) | 1,982 | 1,525 | 655 |
| Current tax liabilities | | 1,130 | 856 | 980 |
| Borrowings | 7(g) | 8,400 | 7,995 | 7,869 |
| Lease liabilities ¹¹ | 8(b) | 3,008 | 2,777 | 2,240 |
| Derivative financial instruments | 12(a) | 1,376 | 1,398 | 445 |
| Employee benefit obligations ⁷ | 8(h) | 690 | 470 | 440 |
| Provisions | 8(i) | 2,697 | 1,240 | 730 |
| | | 35,043 | 27,984 | 26,363 |
| Liabilities directly associated with assets classified as held for sale | 15 | - | 500 | - |
| Total current liabilities | | 35,043 | 28,484 | 26,363 |
| Total liabilities | | 153,429 | 126,681 | 119,250 |
| Net assets | | 157,391 | 115,999 | 94,908 |
| EQUITY | | | | |
| Share capital and share premium | 9(a) | 83,054 | 63,976 | 62,619 |
| Other equity | 9(b) | 1,774 | (550) | (251) |
| Other reserves | 9(c) | 17,993 | 12,381 | 7,395 |
| Retained earnings | 9(d) | 45,108 | 34,503 | 20,205 |
| Capital and reserves attributable to owners of VALUE IFRS Plc | | 147,929 | 110,310 | 89,968 |
| Non-controlling interests | 16(b) | 9,462 | 5,689 | 4,940 |
| Total equity | | 157,391 | 115,999 | 94,908 |

* See note 11(b) for details regarding the restatement as a result of an error and note 8(h)(i) for a reclassification from provisions to employee benefit obligations.

The above consolidated balance sheet should be read in conjunction with the accompanying notes.

Statement of income and expense (Profit and loss account)

Consolidated statement of profit or loss 1-10,12,14,23-26,29-38

| | Notes | 2022 CU'000 | 2021 Restated * CU'000 |
|---|-------|----------------|------------------------------|
| Continuing operations | | | |
| Revenue from contracts with customers | 3 | 197,659 | 161,604 |
| Cost of sales of goods | | (76,992) | (65,159) |
| Cost of providing services | | (25,447) | (18,288) |
| Gross profit | | 95,220 | 78,157 |
| Distribution costs | | (35,794) | (29,221) |
| Administrative expenses | | (17,897) | (14,611) |
| Net impairment losses on financial and contract assets 1-2 | 12(c) | (849) | (595) |
| Other income | 5(a) | 11,348 | 12,033 |
| Other gains/(losses) – net | 5(b) | 4,593 | (671) |
| Operating profit 11 | | 56,621 | 45,092 |
| Finance income 3 | 5(d) | 1,616 | 906 |
| Finance costs | 5(d) | (7,491) | (6,735) |
| Finance costs – net | | (5,875) | (5,830) |
| Share of net profit of associates and joint ventures accounted for using the equity method 13,14 | 16(e) | 340 | 355 |
| Profit before income tax | | 51,086 | 39,617 |
| Income tax expense | 6 | (16,182) | (11,575) |
| Profit from continuing operations | | 34,904 | 28,042 |
| Profit from discontinued operation (attributable to equity holders of the company) 15 | 15 | 727 | 399 |
| Profit for the period | | 35,631 | 28,441 |
| Profit is attributable to: | | | |
| Owners of VALUE IFRS Plc | | 32,626 | 26,123 |
| Non-controlling interests | | 3,005 | 2,318 |
| | | 35,631 | 28,441 |
| | | Cents | Cents |
| Earnings per share for profit from continuing operations attributable to the ordinary equity holders of the company: 18,17 | | | |
| Basic earnings per share | 22 | 56.9 | 47.3 |
| Diluted earnings per share | 22 | 55.8 | 47.1 |
| Earnings per share for profit attributable to the ordinary equity holders of the company: | | | |
| Basic earnings per share | 22 | 58.2 | 48.0 |
| Diluted earnings per share | 22 | 57.1 | 47.8 |

Statement of cash flows (Cash flow statement)

Consolidated statement of cash flows 1-3

| | Notes | 2022 CU'000 | 2021 CU'000 |
|---|-------|-----------------|-----------------|
| Cash flows from operating activities | | | |
| Cash generated from operations | 10(a) | 66,960 | 48,781 |
| Interest received 4 | | 1,262 | 906 |
| Interest paid 4 | | (8,127) | (6,799) |
| Income taxes paid 5 | | (16,458) | (12,163) |
| Net cash inflow from operating activities | | 43,637 | 30,724 |
| Cash flows from investing activities | | | |
| Payment for acquisition of subsidiary, net of cash acquired | 14 | (2,600) | - |
| Payments for property, plant and equipment | 8(a) | (25,387) | (14,602) |
| Payments for investment property | 8(c) | (1,900) | - |
| Payments for financial assets at fair value through other comprehensive income | | (259) | (2,029) |
| Payments for financial assets at amortised cost | 7(b) | - | (1,175) |
| Payment of software development costs | 8(d) | (880) | (720) |
| Loans to related parties | | (1,180) | (730) |
| Proceeds from sale of engineering division | 15 | 3,110 | - |
| Proceeds from sale of property, plant and equipment | | 9,585 | 639 |
| Proceeds from sale of financial assets at fair value through other comprehensive income | | 1,375 | 820 |
| Repayment of loans by related parties | | 469 | 626 |
| Dividends from joint ventures and associates | 16(e) | 160 | 220 |
| Other dividends 4 | | 3,300 | 4,300 |
| Interest received on financial assets held as investments 4 | | 258 | 249 |
| Net cash (outflow) from investing activities | | (13,949) | (12,402) |
| Cash flows from financing activities | | | |
| Proceeds from issues of shares and other equity securities | 9(a) | 12,413 | - |
| Proceeds from calls on shares and calls in arrears | 9(a) | 1,500 | - |
| Proceeds from borrowings | 10(c) | 46,053 | 26,746 |
| Proceeds received under a supplier finance arrangement 7,8 | 7(f) | 3,070 | 2,520 |
| Payments for shares bought back | 9(a) | (1,350) | - |
| Acquisition of treasury shares | | (1,217) | (299) |
| Share issue and buy-back transaction costs | 9(a) | (245) | - |
| Repayment of borrowings | 10(c) | (33,484) | (24,835) |
| Repayments to a financial institution under a supplier finance arrangement 7,8 | 7(f) | (2,980) | (2,550) |
| Principal elements of lease payments | 10(c) | (1,942) | (1,338) |
| Transactions with non-controlling interests | 16(c) | (1,500) | - |
| Dividends paid to company's shareholders | 13(b) | (22,357) | (10,478) |
| Dividends paid to non-controlling interests in subsidiaries | 16(b) | (3,017) | (1,828) |
| Net cash (outflow) from financing activities | | (5,056) | (12,062) |
| Net increase in cash and cash equivalents | | 24,632 | 6,260 |
| Cash and cash equivalents at the beginning of the financial year | | 28,049 | 21,573 |
| Effects of exchange rate changes on cash and cash equivalents | | (248) | 216 |
| Cash and cash equivalents at end of year | 7(a) | 52,433 | 28,049 |
| Non-cash financing and investing activities 9 | 10(b) | | |
| Cash flows of discontinued operation 12 | 15 | | |

The above consolidated statement of cash flows should be read in conjunction with the accompanying notes.

Statement of changes in equity

Consolidated statement of changes in equity ¹⁻³

| | | Attributable to owners of VALUE IFRS Plc | | | | | Non-controlling interests CU'000 | Total equity CU'000 |
|--|-------------------------------------|--|--------------------------|-----------------------------|-----------------|----------------|-------------------------------------|------------------------|
| Notes | Share capital and premium CU'000 | Other equity CU'000 | Other reserves CU'000 | Retained earnings CU'000 | Total CU'000 | | | |
| Balance at 1 January 2021 | | 62,619 | (251) | 7,395 | 21,115 | 90,878 | 4,940 | 95,818 |
| Correction of error (net of tax) | 11(b) | - | - | - | (910) | (910) | - | (910) |
| Restated total equity at the beginning of the financial year | | 62,619 | (251) | 7,395 | 20,205 | 89,968 | 4,940 | 94,908 |
| Profit for the period (restated*) | | - | - | - | 26,123 | 26,123 | 2,318 | 28,441 |
| Other comprehensive income | | - | - | 3,810 | (403) | 3,407 | 258 | 3,665 |
| Total comprehensive income for the period (restated*) | | - | - | 3,810 | 25,720 | 29,530 | 2,576 | 32,106 |
| Costs of hedging transferred to the carrying value of inventory purchased during the year | 12(a) | - | - | 237 | - | 237 | - | 237 |
| Transfer of gain on disposal of equity investments at fair value through other comprehensive income to retained earnings | 7(c) | - | - | 384 | (384) | - | - | - |
| Transactions with owners in their capacity as owners: | | | | | | | | |
| Contributions of equity net of transaction costs | 9(a) | 1,357 | - | - | - | 1,357 | - | 1,357 |
| Acquisition of treasury shares | 9(b) | - | (299) | - | - | (299) | - | (299) |
| Dividends provided for or paid | 13(b) | - | - | - | (11,038) | (11,038) | (1,827) | (12,865) |
| Employee share schemes – value of employee services | 9(c) | - | - | 555 | - | 555 | - | 555 |
| | | 1,357 | (299) | 555 | (11,038) | (9,425) | (1,827) | (11,252) |
| Balance at 31 December 2021 (restated*) | | 63,976 | (550) | 12,381 | 34,503 | 110,310 | 5,689 | 115,999 |

* See note 11(b) for details regarding the restatement as a result of an error.

| | | Attributable to owners of VALUE IFRS Plc | | | | | | |
|--|----------------------------------|--|------------------------|--------------------------|-----------------------------|-----------------|-------------------------------------|------------------------|
| | | Share capital and premium CU'000 | Other equity CU'000 | Other reserves CU'000 | Retained earnings CU'000 | Total CU'000 | Non-controlling interests CU'000 | Total equity CU'000 |
| Notes | | | | | | | | |
| Balance at 31 December 2021 as originally presented | | | | | | | | |
| | | 63,976 | (550) | 12,381 | 35,588 | 111,395 | 5,689 | 117,084 |
| | Correction of error (net of tax) | 11(b) | - | - | (1,085) | (1,085) | - | (1,085) |
| Restated total equity as at 31 December 2021 | | | | | | | | |
| | | 63,976 | (550) | 12,381 | 34,503 | 110,310 | 5,689 | 115,999 |
| Profit for the period | | | | | | | | |
| | | - | - | - | 32,626 | 32,626 | 3,005 | 35,631 |
| Other comprehensive income | | | | | | | | |
| | | - | - | 5,501 | 307 | 5,808 | (99) | 5,709 |
| Total comprehensive income for the period | | | | | | | | |
| | | - | - | 5,501 | 32,933 | 38,434 | 2,906 | 41,340 |
| Hedging gains and losses and costs of hedging transferred to the carrying value of inventory purchased during the year | | | | | | | | |
| | 12(a) | - | - | (31) | - | (31) | - | (31) |
| Transfer of gain on disposal of equity investments at fair value through other comprehensive income to retained earnings | | | | | | | | |
| | 7(c) | - | - | (452) | 452 | - | - | - |
| Transactions with owners in their capacity as owners: | | | | | | | | |
| Contributions of equity, net of transaction costs and tax | | | | | | | | |
| | 9(a) | 10,871 | - | - | - | 10,871 | - | 10,871 |
| Issue of ordinary shares as consideration for a business combination, net of transaction costs and tax | | | | | | | | |
| | 14 | 9,730 | - | - | - | 9,730 | - | 9,730 |
| Acquisition of treasury shares | | | | | | | | |
| | 9(b) | - | (1,217) | - | - | (1,217) | - | (1,217) |
| Buy-back of preference shares, net of tax | | | | | | | | |
| | 9(a) | (1,523) | - | - | 143 | (1,380) | - | (1,380) |
| Value of conversion rights on convertible notes | | | | | | | | |
| | 9(b) | - | 2,450 | - | - | 2,450 | - | 2,450 |
| Non-controlling interests on acquisition of subsidiary | | | | | | | | |
| | 14 | - | - | - | - | - | 5,051 | 5,051 |
| Transactions with non-controlling interests | | | | | | | | |
| | 16(c) | - | - | (333) | - | (333) | (1,167) | (1,500) |
| Dividends provided for or paid | | | | | | | | |
| | 13(b) | - | - | - | (22,923) | (22,923) | (3,017) | (25,940) |
| Employee share schemes – value of employee services | | | | | | | | |
| | 9(c) | - | - | 2,018 | - | 2,018 | - | 2,018 |
| Issue of treasury shares to employees | | | | | | | | |
| | 9(b) | - | 1,091 | (1,091) | - | - | - | - |
| | | 19,078 | 2,324 | 594 | (22,780) | (784) | 987 | 83 |
| Balance at 31 December 2022 | | | | | | | | |
| | | 83,054 | 1,774 | 17,993 | 45,108 | 147,929 | 9,462 | 157,391 |

The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.



Balance sheet - deep dive

Asset

An asset is a present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits.

Example:

- Property, Plant and Equipment.
- Investment.
- Cash.
- Trade receivables.
- Prepayments.



Liability

A liability is a present obligation of the entity to transfer economic resource as a result of past events. An obligation is a duty of responsibility that the entity has no practical ability to avoid.

Example:

- Borrowings/overdrafts.
- Tax payables.
- Trade payables.
- Accruals.
- Pension liabilities.



Equity

Equity is the owners' residual interest in the assets of a company, net of its liabilities.



Accounting journals entry - examples

Selling a building for cash

| | Debit (£) | Credit (£) |
|----------|-----------|------------|
| Cash | 100 | |
| Building | | (100) |

Taking out a loan

| | Debit (£) | Credit (£) |
|----------------|-----------|------------|
| Cash | 100 | |
| Loan liability | | (100) |

Capital reduction

| | Debit (£) | Credit (£) |
|---------------|-----------|------------|
| Share capital | (10) | |
| Share premium | (100) | |
| P/L reserve | | 110 |



3

Distribution and reserves



What elements of equity are distributable?

| Equity | Distributable? |
|---|----------------|
| Share capital | No |
| Share premium | No |
| Capital redemption reserve | No |
| Merger reserve | ? |
| Revaluation reserve | ? |
| Foreign currency reserve | ? |
| Other reserve | ? |
| Profit and loss reserve (retained earnings) | ? |

Dividends

Distributions can only be made from profits available for the purpose (*CA06 s830 (1)*).

Realised profit

In most instances, arises from a transaction where the consideration received by the company is '**qualifying consideration**'

It is required that transactions are not looked at in isolation and overall commercial effect on the company is that it meets definition of realised profit (**linkage test**)

Also, unrealised profits can become realised, and vice versa

Realised loss

Defined as all losses except to the extent that the law, accounting standards or Tech 02/17 provide otherwise

P&L reserves **≠** realised profits

Common complications

- Unlawful distribution.
- Transferring trade and assets at book value with negative reserves.
- Impairments and dividend blocks.
- Overseas jurisdiction rules.

Ways we can help

Transaction structuring (with tax and legal).

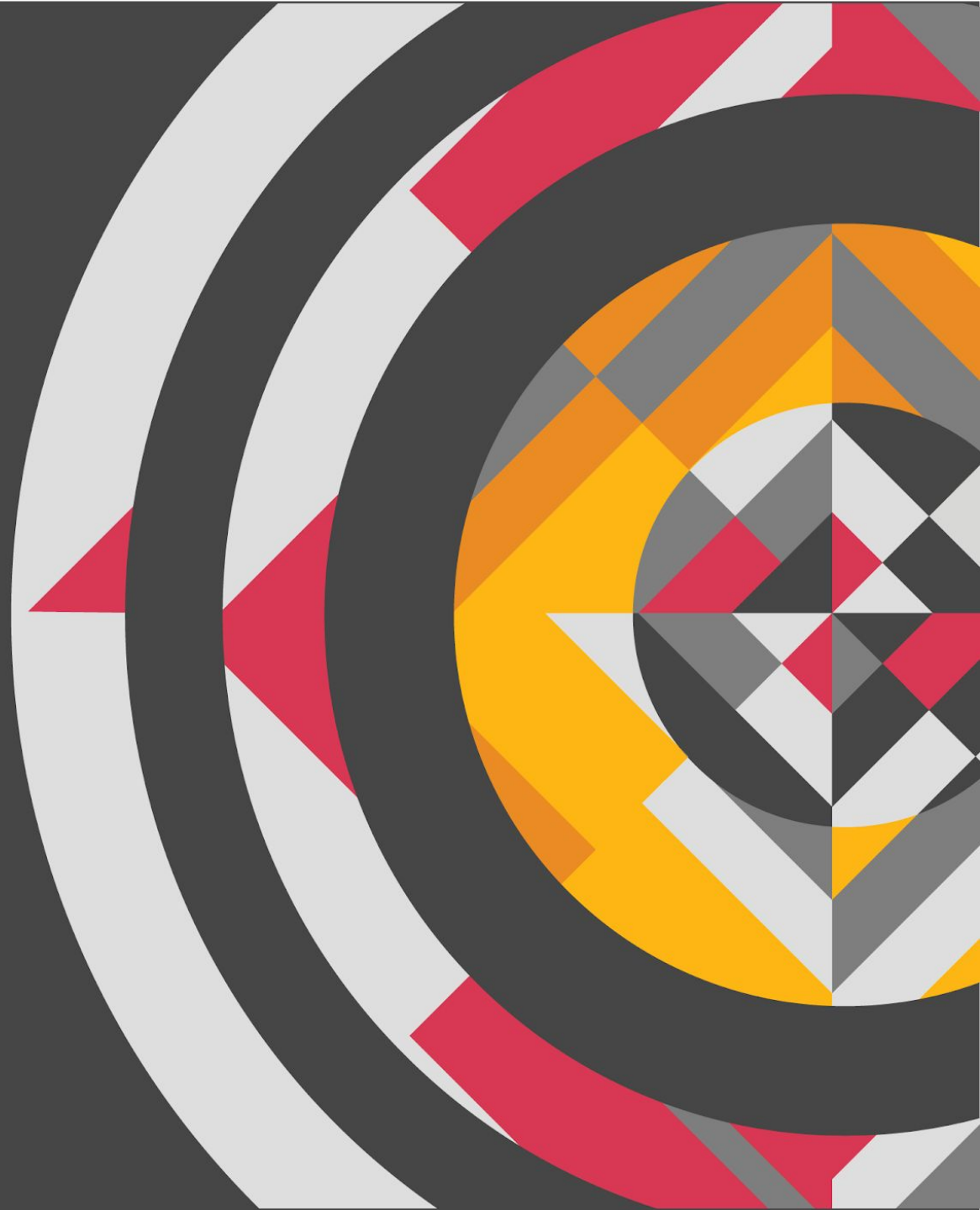
Reserves analysis (opening and in respect of transactions).

Illustrative balance sheet model.

Others.



Questions and feedback



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