



**From Industrial Organisation Economics to Financial Analysis:
Accounting and Financial Analysis in Competition Policy¹**

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PART 1: What is Accounting and Financial Analysis?

Introduction

Industrial Organisation (IO) economics has fundamentally shaped competition law and policy, providing a theoretical framework to assess competition cases across a wide range of industries. IO tools are widely used for analysis in many competition cases, particularly in market definition and assessing both mergers and abuse of dominance. However, IO economics has consistently fallen short when it comes to tackling harms caused by size, market power and concentration, for example in cases with suspected excessive pricing.² Accounting and financial analysis (“AFA”) provides a complementary set of tools that are already utilised in some areas of competition law: such as when a firm is failing or when deciding upon remedies to proven harms. However, AFA can and should be applied more broadly in competition law enforcement because it often provides clearer answers to tricky cases and it more directly identifies abuse caused by size and market power. This requires competition authorities to reinforce their financial analytical skills-base and expertise in order to firstly identify and then remedy unaddressed competition and consumer problems, through contributing business and financial analysis as part of the overall assessment of evidence in competition and merger cases.

In this paper we will briefly explain what AFA is, provide some examples of where it has been successfully applied in different areas of competition law enforcement, and follow on with a detailed case study. The final part is breakdown of what information can be found in company accounts and from where, as these documents are often the foundations for this approach.³

Accounting and financial analysis – what is it?

How does a company’s management measure and demonstrate their success (or failure) to stakeholders (e.g. shareholders, tax authorities, workers, suppliers, customers, lenders)? The company’s reports and financial accounts are the key way to do this. These documents use

² <https://www.concurrences.com/en/review/issues/no-2-2024/foreword/the-tool-is-the-message-time-to-improve-the-antitrust-toolbox-118015>

³ The following write-up and explanation is built off publicly available information, press releases, and decisions by the European Commission along with a presentation given in a personal capacity at Lund University (in 2023) by European Union civil servant Helena Malikova, who is also a fellow at Harvard Kennedy School's Carr Center for Human Rights Policy and a fellow at the Centre for Digital Governance at the Hertie School, Berlin. The presentation and interpretation of these source materials is at Balanced Economy Project’s discretion in line with our aim to challenge unaddressed monopoly power and the harms that it causes.

the more commonly understood language (and tools) of financial accounting and reporting to communicate the business's health and progress towards its goals.

The reliance on these reports (and the accounting information provided within) has persisted over centuries because they are relevant, comparable, and factual.

They are relevant in that the figures produced (and key performance indicators calculated from them) are used by the firm's management to make strategic and operational decisions (such as mergers and pricing), determine the pay and bonuses of management, and by shareholders to determine whether their investment in the company is worthwhile.

The use of national or international accounting standards enables comparability, allowing management and shareholders to fairly assess competitors to measure how well they are faring against each other. This in turn will affect decisions around pricing, cost control, and possible mergers or divestments.

Finally, the requirement for medium-to-large companies to have an external audit (i.e. inspection) of the key figures and statements in their accounts provides some reassurance that what is presented is factual and reliable.

AFA builds on these transparency, comparability, and relevance of financial data to understand how businesses actually made decisions in competition-critical areas such as pricing, mergers, profits, and divestments. For example, it would be interested in measuring the following:

- **Profitability (often relative to revenue or capital):** To assess how well a business is doing versus its competitors (high profits may indicate low levels of competition); and to assess the likely profitability of anti-competitive actions upon merging.
- **Cash or debt levels:** to assess whether a business is failing (and so needs a to merge); to assess the health of a proposed purchaser of a divested company/business unit.
- **Spend on capital expenditure:** Can help determine the levels of investment by the business and whether innovation would likely be helped or hindered by a merger.

These can all be calculated using standard ratios and techniques used by company managers, financial analysts, competitors, and lenders. In the final part of this document, we will explain these in further detail.

PART 2: The use of AFA in competition policy cases

This section provides examples of when AFA has been used in competition law enforcement and merger cases. Its inclusion has enhanced the courts' understanding of the actual business situation (in each case) enabling more grounded judgements on whether competition law has been, or will be, breached. AFA is mainly applicable for mergers, state aid and certain abuse of dominance cases.¹ This section provides brief examples of the successful use of AFA in different types of competition cases and is followed by a more detailed case study of a major excessive pricing case.

a. Assessment of divestments

Divestments are a potential remedy for mergers that raise competition concerns, instead of a competition authority potentially blocking the merger. In general, the remedy requires that a viable part of the business is divested to an independent buyer and that it can compete effectively with the newly merged entity on a lasting basis.⁴

For the proposed merger of pigment producers DIC and BASF the European Commission ("EC") cleared the deal subject to the condition that part of DIC's business was divested.⁵ A private equity ("PE") owned purchaser, called DCL, was identified as a possible purchaser. The Commission used financial analysis to assess the financial strength of DCL and compared it to similar companies (both of these approaches are not possible using IO economics).⁶ The Commission looked at measures such as debt to profitability and debt to total assets, to see how financially viable DCL was, and through these identified financial sustainability concerns about the purchaser (DCL). To remedy these, DCL's PE owners had to inject more money into the business and commit to maintaining a stronger financial position with their lenders.⁷ In this case financial analysis identified a purchaser at risk of asset stripping the divested business and forced them to more strongly support and invest in the divested business. This demonstrates how the analysis can improve the potential for the divested business to remain an effective competitor over a longer time period.

b. Assessment of incentives to foreclose

When a business merges with a supplier it creates an entity which is vertically integrated. If a business controls key parts of an industry's supply chain, it can increase the price of or restrict access to key inputs in order to damage competitors. This form of restricting access is called

⁴ [https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52008XC1022\(01\)](https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52008XC1022(01)) paras 22-31.

⁵ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020M9677&qid=1734095445200>

⁶ https://ec.europa.eu/competition/mergers/cases1/202205/M_9677_8149323_3017_3.pdf 2.2.1 (14)

⁷ https://ec.europa.eu/competition/mergers/cases1/202205/M_9677_8149323_3017_3.pdf 2.2.1 (12)-(13)

‘input foreclosure’ and is most likely when the company controls a valuable, high profile ‘masthead’ product.

For example, in the merger of London Stock Exchange Group (LSEG) and Refinitiv there were concerns that following the transaction, LSEG could restrict access to FTSE Russell UK equity indices information by rivals of Refinitiv’s products. As the indices are important for users this action could force them to subscribe to Refinitiv instead.⁸ Using financial analysis (of profit margins), interviews of customers and rivals, and assessing past behaviour, the European Commission estimated that the profits lost from not supplying index data to rivals was lower than the profit gain from new subscriptions to Refinitiv, meaning that LSEG would have the incentive and ability to engage in anti-competitive foreclosure. To address these concerns, LSEG committed to specific remedies, such as providing open and non-discriminatory access to its clearing services for interest rate derivatives and its data feeds, which ultimately allowed the merger to be cleared subject to these conditions.⁹

c. Failing firm defence

A merger that would be detrimental to competition may still be allowed to go ahead if one of the merging parties is considered to be a failing firm. If a firm is in financial difficulties and expected to leave the market in the near future then competition will drop anyway, and so a merger with a healthier rival may be considered a better outcome.¹⁰ However, successful failing firm defences have in practice rarely been accepted by competition authorities as the evidential burden on merging parties is very high. That said since the Covid-19 pandemic there have been more instances of merging parties being able to meet the criteria for a merger approval based on the failing firm defence and an apparent shift in approach by competition authorities when applying the test.

Financial analysis could be used here to assess the health of the company that claims it is a failing firm. While there are not many cases where the failing firm defence has been deployed and relatively few where it has been accepted, one such case involved the merger of two passenger airlines (Aegean and Olympic). This merger would have eliminated the most credible competitor on a number of routes, degrading effective competition. However, Olympic airlines claimed to be failing financially as a defence for the merger and following financial analysis the Commission was inclined to agree on the basis that Olympic had never been profitable since its privatisation and had since then received considerable financial support from its sole shareholder. The Commission examined Olympic's business prospects

⁸ [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021M9564\(02\)](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021M9564(02)) para 2.2-2.4

⁹ [https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021M9564\(02\)](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021M9564(02)) para 2.2 (27)

¹⁰ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52004XC0205%2802%29> paras 89-91

and concluded it was extremely unlikely that the company would become profitable in the foreseeable future, under any business plan.¹¹

d. Exploitative abuses

Exploitative abuses include practices by a dominant company that uses its market power to harm consumers, such as charging excessive prices or imposing unfair trading conditions and unfairly discriminating against customers. Excessive prices (and the associated profits) are hard to measure using IO economics which struggles to estimate costs and other key variables, this often means that no harm can be demonstrated using this approach. However, financial analysis can be a powerful tool in these cases because if a company's profits are higher than its competitors' then it indicates that competition is not working correctly.

¹¹ https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=uriserv:OJ.C_.2015.025.01.0005.01.ENG

PART 3: Aspen Pharmacare: how AFA identified excessive pricing in cancer treatments

Background: determining if Aspen was abusing its dominance in the market for certain cancer treating medicines

In 2017 The European Commission (“Commission”) started looking into the pricing of medicines by Aspen, a pharmaceutical company headquartered in South Africa. Aspen had acquired a range of off-patent mostly essential cancer-treating medicines (the “products”) from GlaxoSmithKline plc in 2009. In 2011 Aspen developed a plan to drastically increase prices for these products across Europe, often putting prices up by several hundred percent. In countries where health authorities resisted these increases, Aspen used the threat of withdrawing the products from the country as a tactic to get its way. It maintained these high prices from 2012 onwards in some countries.¹²

As part of its initial investigation the Commission found that Aspen had very high market shares for these products: often 90-100% of the market in Europe. The measurement of profit margins (a financial analysis technique) helped the Commission demonstrate that Aspen had this dominant position, because it had maintained high profitability (over a long period of time) and no effective competition had emerged to eat away at these lucrative profits.¹³ Indeed, emails between Aspen employees at the time found that patients depended upon the chosen products and generally had no substitutes, meaning that large price increases were recommended to, in effect, abuse the company’s dominant position.¹⁴ One email between employees explained the logic behind the pricing opportunity because “*in almost all the markets [...] there is no replacement on the products targeted*”.¹⁵

As a demonstration of its dominance during price negotiations Aspen applied a stock allocation system (i.e. quota) to prevent countries buying these essential medications from each other. Thus, creating a ticking time bomb situation where cancer patients risked not receiving these essential medications unless their country’s health authority quickly yielded to the massive price increases being forced through.¹⁶ Aspen’s instructions for negotiations with national authorities was:

¹² https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 4, 6, 12, 15, 90-99

¹³ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 66-72

¹⁴ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 87-89, 93

¹⁵ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 187

¹⁶ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 100-101

“Take it or leave it. No other alternative. If the local MOH [Minister of Health] doesn’t accept the new price, we will either sell with no reimbursement or not supply at all. No place for negotiations.”¹⁷

Use of financial analysis to calculate excess prices and profits

In order to determine whether Aspen’s price rises were exploitative the Commission used an existing legal methodology to measure if the profits made were excessive.^{18 19} To do that it used Aspen’s financial accounts (here the profit and loss/SOCI) to measure Gross Profit and EBITDA profit (earnings before interest, tax, depreciation, and amortisation).²⁰

- Gross Profit is Revenue (from the products) minus the Cost of Goods Sold (“COGS”). COGS include the direct costs of producing the medicines e.g. labour and material costs.
- EBITDA takes the Gross Profit and deducts other operating costs (such as logistics and distribution costs).
- In addition, for both, a share of indirect costs (i.e. ones not directly related to the products) was deducted. Indirect costs include head office overheads and employee costs for those working in “support” teams such as legal, finance, or HR departments.

Competition investigation findings

1. Aspen consistently earned very high profits on these products following the price rises in FY2013

The Commission estimated that from financial years (“FY”) 2013-2019 (across all the relevant products and countries except Italy) Aspen made:

- a gross profit margin of 80-90% (versus 60-70% in 2012); and
- an EBITDA profit margin of 80-90% (versus 40-50% in 2012).

This means that **80-90% of the net sales revenue it received for these products became profit**, and the Commission stated that these profits were in excess of €200m over that period.²¹

¹⁷ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para192

¹⁸ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 102

¹⁹ This methodology followed the approach laid out in the *United Brands* judgement.

²⁰ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 106-121

²¹ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 122-126

2. Aspen earns significantly higher profits than similar companies

Another advantage of financial analysis is that it allows for peer comparisons. The Commission found that for similar pharmaceutical companies the median:²²

- gross profit margin was 54% (compared to Aspen's 80-90%); and
- EBITDA profit margin was 23% (compared to Aspen's 80-90%).

Not a single peer company had as high an EBITDA margin as Aspen's products, with 90% of all profit margins below 37% EBITDA.²³

The Commission then took the 23% EBITDA profit measure and looked at the difference between Aspen's actual prices and the hypothetical prices if it charged a price that was the cost of production plus a more reasonable 23% profit margin (in line with its peers) on top. It found that on top of a reasonable return (of 23% EBITDA profits) Aspen was earning **additional profits of three times the reasonable costs**.²⁴ It's worth noting that even before the price increases these products had an EBITDA profit margin of 40-50%, so already higher than the peer median of 23%.

Using AFA to draw preliminary conclusion of excessive profits

Taken together the financial analysis of durable high profitability, its dramatic increase compared to before the price rises, and Aspen's high profitability/prices relative to peers allowed the Commission to conclude that Aspen may have been earning *excessive profits* in Europe since the price rises.²⁵

How AFA supported the assessment that the price increases were unfair

In addition to identifying excessive profits the Commission is required to assess whether the prices increases are unfair. So it assessed whether there were other mitigating factors for the high prices such as superior efficiencies in the production or sale of the products or innovations that justify a higher price. It found none: these were off-patent treatments where Aspen had never carried out any material R&D (which is recorded in the accounts), and production was outsourced to third party manufacturers.²⁶ Indeed, accounting data showed that the price increases were disproportionate to the change in the costs of production.

²² https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 127-131

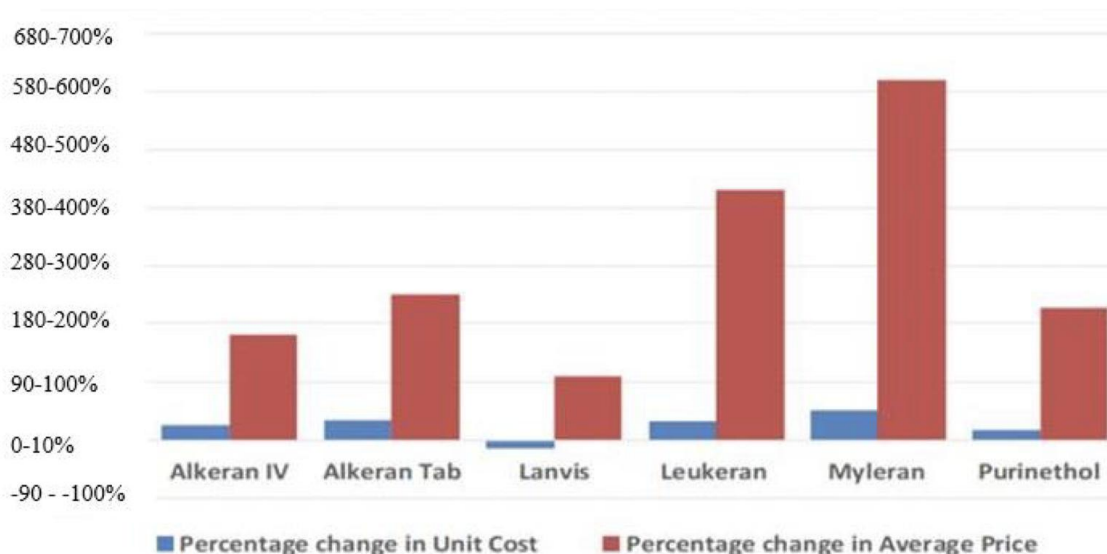
²³ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 182-185

²⁴ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 140-145

²⁵ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 152

²⁶ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 161-176

Figure 1: Percentage change in the unit costs of production (EUR / Standard Unit) and the percentage change in average prices, by Product, FY2012 to FY2019, in the EEA (excluding Italy)



Source: https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf Graph 1, p33

Conclusion

Financial analysis was a core analytical pillar in the Commission’s case against Aspen. It provided a clear way to quantify the excessiveness of prices and profits, whilst also providing a consistent yardstick to measure this excessiveness against similar companies. Furthermore, the financial information, and approach used, are more readily available publicly (albeit at a higher level), and is more in line with how businesses think when setting prices.

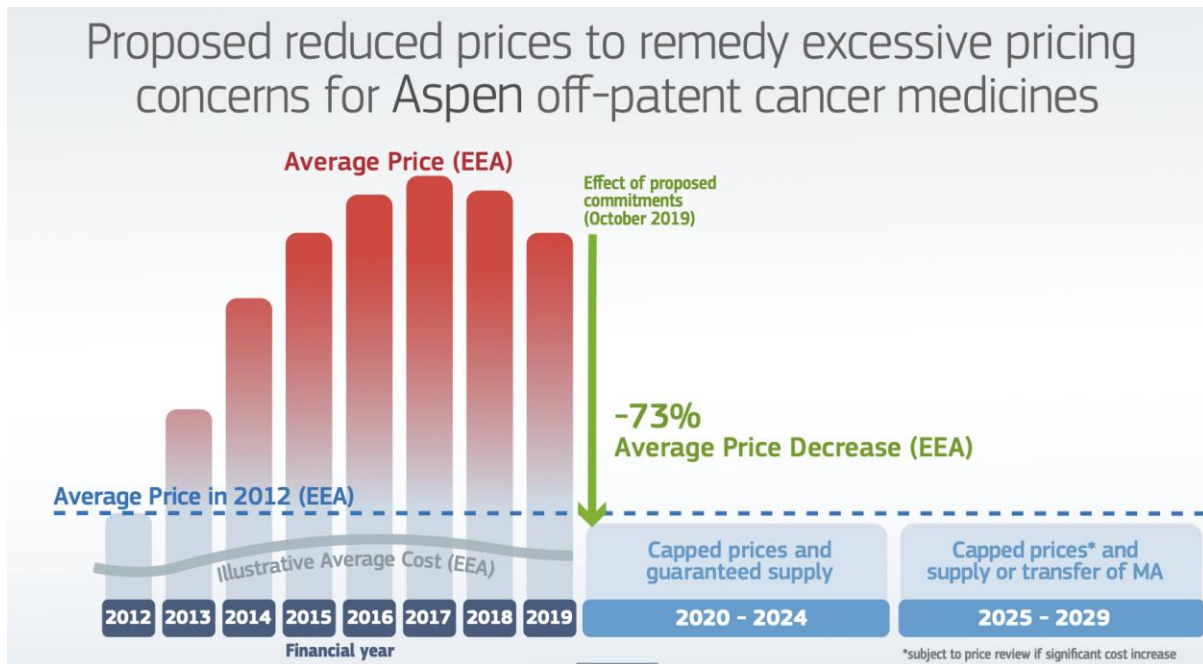
The harm caused by these price rises was not limited to stretching patient and public health budgets. Health budgets are finite and so extra spend on Aspen’s products left less available for other areas of care. England’s National Health Service (“NHS”) illustrated this point:

“The NHS has a limited pot of money, so the more it spends on the drugs bill, the less it can afford other healthcare services, for example we have estimated that an increase of £4.3 million to the drugs bill [caused by Aspen’s products per annum] means a loss of 332 Quality Adjusted Life Years (QALYs), which is the standard unit of health (this would include 22 additional patient deaths which otherwise would have been avoided).”²⁷

²⁷ https://ec.europa.eu/competition/antitrust/cases/dec_docs/40394/40394_5350_5.pdf para 194

As part of the restitution for the harm caused Aspen agreed to reduce its prices by, on average, 73% across its products (from October 2019) and guarantee the supply of these products for the subsequent 10 years.²⁸

Figure 2: Change in average price of the products over time versus the pre-hike (2012) price and the effect (on prices) of the proposed remedy



Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1347

²⁸ https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1347

PART 4: Sourcing information for AFA

This section provides an explanation of where to find accounting data, what the different documents show, and how they can be used for AFA. In a competition case or merger review the competition authorities would be provided this information by the investigated companies or merging parties, however policy-makers, journalists, Parliamentarians, and other interested parties can use public information to perform a similar analysis on companies of interest. AFA's transparency is a powerful tool in identifying, quantifying, and challenging market abuse.

The main accounting documents – where they are and what they tell us

i. Where to find data

Within the **EU** limited liability legal entities are obliged to produce and publish financial statements and management reports. The relevant Directive (2013/34/EU) ensures a degree of comparability between accounts, and notes that annual financial statements are not just useful for investors but also for enhancing corporate governance and providing a record of past transactions.²⁹ However, some non-limited liability structures are exempt from these rules.³⁰

In the **US** publicly-listed corporations (and certain other organisations) are required to file documents with the US Securities and Exchange Commission ("SEC"). These documents mandate the disclosure of key information about a company's activities, financial performance, risks, compensations, and ownership. These documents (filed annually, quarterly, or when triggered by an event) are made available on the SEC's EDGAR database.³¹

However, the situation is more opaque for private companies that are not usually under any obligation to file public accounts (unless, for example, they issue publicly-traded debt). This means that there are some large multibillion dollar private companies that are not required to file public accounts.^{32 33}

In the **UK** public and private companies are required to produce annual accounts as per the Companies Act 2006 (with some exceptions for dormant and unlimited companies). Depending upon the size of the company they may also have to prepare a Strategic and

²⁹ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32013L0034>

³⁰ A link to European and international registries: <https://www.gov.uk/government/publications/overseas-registries/overseas-registries>

³¹ <https://www.sec.gov/search-filings>

³² For example: <https://www.forbes.com/lists/largest-private-companies/>

³³ See Methodology at bottom. <https://www.forbes.com/sites/andreamurphy/2023/11/14/americas-largest-private-companies-2023-cargill-stays-on-top-spacex-debuts/>

Directors' report.³⁴ For most companies these filings are freely available via Companies House.³⁵

ii. Key information

A quick note on accounting standards – the languages for accounting data

Before diving in we need to note that there are different accounting rules and standards for how transactions and events are measured and reported in a company's financial statements. Within the EU (and more widely internationally) **International Financial Reporting Standards** ("IFRS") are the most commonly used. IFRS was created as a common global accounting language making it easier to understand business accounts across companies and countries, with the hope that this in turn would improve efficiency for investors.³⁶

In the US a different accounting standard, **US GAAP** (Generally Accepted Accounting Principles) is still more prevalent, and this has persisted despite past attempts by the US SEC to encourage adoption of IFRS.³⁷ In the UK companies can prepare their financial statements using UK GAAP or IFRS, with IFRS required for publicly-listed ones.^{38 39}

In broad brush terms IFRS adopts a more principles-based approach to reporting transactions, whilst GAAP is more of a rules-based approach. In addition, IFRS is designed for profit-orientated entities whilst US GAAP is designed for non-profits too.⁴⁰

Key documents for analysis – what to focus on when there are competition concerns

For a medium to large-sized company you will usually find the following key documents in the financial accounts:

- Statement of profit or loss and other comprehensive income (IFRS) / statement of comprehensive income (US GAAP)
- Statement of financial position
- Statement of cash flows

³⁴ <https://www.legislation.gov.uk/ukpga/2006/46/part/15>

³⁵ <https://find-and-update.company-information.service.gov.uk>

³⁶ <https://www.ifrs.org/use-around-the-world/why-global-accounting-standards/>

³⁷ <https://www.sciencedirect.com/science/article/pii/S0278425422000795>

³⁸ <https://www.gov.uk/hmrc-internal-manuals/corporate-finance-manual/cfm20020>

³⁹ <https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/view-jurisdiction/united-kingdom/>

⁴⁰ For a comparison see for example p6-11 of: <https://kpmg.com/kpmg-us/content/dam/kpmg/frv/pdf/2023/ifrs-us-gaap-2023-final.pdf>

- Statement of changes in equity (IFRS/US GAAP) or disclosed in the notes to the financial statements (US GAAP)

For a small company (defined by the size of turnover, size of its assets, and/or number of employees) you may only be able to publicly access a Statement of Financial Position, and the format of the accounts may vary slightly.

Consolidated financial statements – what they are and why we might use them

In addition, you may find that companies present **consolidated** financial statements, which can be useful for looking at how well a whole group of companies are doing. Under IFRS and US GAAP, entities with one or more subsidiaries (companies that they control) typically present accounts which aggregate both them and their subsidiaries assets, liabilities, equity, income, expenses, and cash flows.⁴¹ This gives you a picture of how all these companies are performing as an aggregated business. However, under IFRS a company does not need to present consolidated accounts if a more senior company (one that controls it directly or indirectly) does so instead.

iii. What the accounting documents show⁴²

Before we dive in, let's reiterate that we are using company reports and financial accounts to understand how well a business is doing (using its own and industry metrics), what its strategy is, and then using these insights to inform our judgement of a merger/competition case. Most of these statements will present information for the financial period covered (usually 12 months but note this may not align with the dates of the calendar year) and the prior financial period, to enable a comparison of progress over time.

Going through each of the accounting documents in turn:

a) Statement of profit or loss and other comprehensive income ("SOI")

The Statement of profit or loss and other comprehensive income ("SOI") measures the **financial performance** of a company throughout a time period (usually a year). It can be one statement or two statements (one showing just profit and loss immediately followed by another presenting comprehensive income).

⁴¹ There are (as always) exceptions to this. For both standards investment companies are exempt from preparing consolidated statements. In addition, under IFRS there are a number of additional exemptions for companies without publicly-traded instruments or plans to trade them. See:

<https://www.iasplus.com/en/standards/ifrs/ifrs10>

⁴² NB. We will predominantly focus on IFRS accounts here as this is the standard in use for most relevant European companies. Further details on the requirements for each financial statement can be found here:

<https://www.iasplus.com/en/standards/ias/ias1>

All income and expenses must be recorded in profit and loss, although some can be recorded in 'other comprehensive income' (typically changes in the value of assets, pensions, foreign exchange differences, and some financial instruments).

Total comprehensive income = Profit or loss + Other comprehensive income

This statement(s) shows the **change in 'equity'** for a company during a period resulting from transactions and other events. Equity is the value that would be returned to shareholders if a company sold all its assets and paid off its debts. Any profit/loss made in the period increases/reduces the equity of the company.

Some of the key lines that we will usually see in this statement are:

- Revenue/Sales/Turnover
- Spend on expenses
- Various measures of profitability/results e.g. gross, operating, profit before tax, profit after tax
- Tax expense (but note that this will often include more than just that tax charge on profits made in the year)

Often the **Notes to the accounts** will provide further information and breakdowns of income, expenses, and key geographical/product/business unit performance.

b) Statement of Financial Position ("SFP")

The Statement of Financial Position ("SFP") shows what *assets* a company owns and how these assets are financed, either through debt (more broadly categorised as *liabilities*) and/or *equity*.

The SFP follows this equation: ***Assets = Liabilities + Shareholder's Equity***

By definition the value of the assets must equal the sum of the liabilities and equity: in other words, it must balance, which is why the SFP is often referred to as the 'balance sheet'.

Unlike the SOCI (above), the SFP is a **snapshot of the company's financial position** at a specific date (usually the last day of the financial period). For this reason, it is important to compare snapshots from prior years to identify emerging trends.

Within the SFP assets and liabilities will be split between those that are *current* and *non-current*. Current usually means that the asset or liability is expected to be realised/settled within

12 months of the end of the financial period of the accounts.⁴³ Non-current is for anything that is not defined as current. The key items within each of these categories are:

- Current Assets: assets such as cash; sales invoiced but not yet paid (“accounts receivable”); and inventory.
- Non-Current Assets: tangible assets such as property (including land), plant, and equipment; Intangible assets such as the value of patents, licences, brand value, and the goodwill from purchasing other companies; and Long-term investments.
- Current Liabilities: the portion of debt due within a year; money owed to suppliers which hasn’t yet been paid (“accounts payable”); wages payable; rent and utility payments due; and other accrued expenses (incurred but not paid at the date of the SFP).
- Non-current Liabilities: the portion of debt/financial obligations due in over a year’s time; pension fund liabilities (that the company expects to pay on behalf of its current or previous employees); and deferred tax liability (taxes that will not be paid for over another year).
- Share Capital: value of funds that shareholders have put into the company.
- Retained Earnings: the amount of profits after tax that a company retains. This balance of accumulated profits (and losses) can be used to pay out dividends or can be reinvested back into the business. As we noted about the SOCI measures the *change in equity* in a company because the result of the SOCI flows through to retained earnings: a profit will increase retained earnings and a loss will reduce it.

The **Notes to the accounts** will provide further detail on the items in the SFP.

c) Statement of Cash Flows (“SCF”)

The Statement of Cash Flows (“SCF”) shows how cash and cash equivalents have changed throughout a time period (usually a year). Cash and cash equivalents include cash on hand and in demand deposits, along with highly liquid investments that are readily convertible into a known amount of cash (usually in under three months).⁴⁴

The SCF provides an itemized list of where a company receives money from, and how it spends it. It differs from the profit in the SOCI because it focuses only on movements in cash. Whilst in the SOCI income and expenses which are not yet paid in/out will be included if they relate to that financial period. For example, a sale to a customer will be recorded as income in the SOCI, but if the customer hasn’t paid by the date of the accounts, then no corresponding cash in will be noted in the SCF.

⁴³ In addition, it could be realised within the entity’s normal operating cycle and is held primarily for the purpose of trading. For further details please see: <https://www.iasplus.com/en/standards/ias/ias1>

⁴⁴ <https://www.iasplus.com/en/standards/ias/ias7>

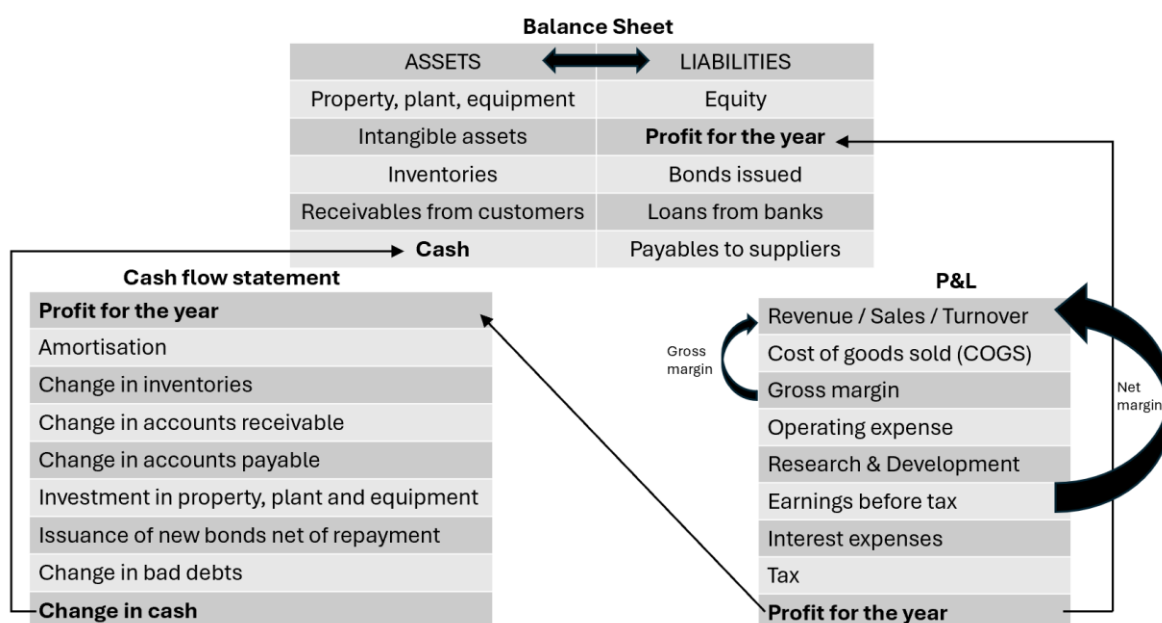
The SCF is split into three parts:

- Cash flows from Operating Activities: the cash generated from/used in a company's products/services. This will include cash received from customers, and those paid out to suppliers and employees.
- Cash flows from Investing Activities: the acquisition and disposal of long-term assets and investments e.g. the purchase of equipment, buildings, payments related to mergers and acquisitions.
- Cash flows from Financing Activities: cash flows relating to borrowing, dividends, or stock buybacks.

d) Statement of Changes in Equity ("SOCE")

The Statement of Changes in Equity ("SOCE") shows how the equity in a company has changed throughout a time period (usually a year). It includes dividend payments; comprehensive income for the year; changes in share capital; and other items that are not included in the SFP or SOCI.

Figure 3: Summary of key ways the three main financial statements link together:



Source: This graphic is adapted by permission from its original author Helena Malikova.