FINANCIAL REPORTING:

15 Key Terms to get you started

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Preface

In 2018, the Friedrich Ebert Stiftung Trade Union Competence Centre (FES TUCC) and the Labour Research Service (LRS) published the first in a series of guides aimed at providing researched-based bargaining support to unions.

The first guide, titled South African Multinational Corporations in Africa: Bargaining with Multinationals, provides a step-by-step approach to assist Global Union Federations (GUFs) and their affiliates in utilising company information when preparing for bargaining processes.

As a follow-up to the first guide, this guide will take you through a series of terms which are used regularly in companies' Annual Reports.

Contents

How can this guide help me?

Expanding your practical knowledge of the financial terms corporate companies use will enable you to read annual reports and corporate documents. There are some basic financial terms that every union member should know when they start to deal with a company and its management. These terms could be used in meetings or during bargaining, and your ability to understand these terms will affect your negotiating power.

This guide is not all-encompassing, but rather aims to provide you with the tools to understand the basics of financial reporting. It uses Shoprite's most recent Integrated Annual Report as an example. Shoprite is Africa's largest food retailer, operating outlets in 15 countries.

Unions and shop stewards will come across these terms specifically when bargaining for employee wages. Information relating to company revenue, profits and directors' remuneration can assist negotiators in securing employee wage demands.

This guide is not all-encompassing, but rather aims to provide you with the tools to understand the basics of financial reporting.

USE THIS GUIDE TO **UNDERSTAND KEY TERMS** IN REPORTS

The first guide in this series, which provides information on how to use company information, can be used in conjunction with this guide, which can be used to clarify some of the terms used.

The Multinational Corporations (MNC) Database[1] holds company reports that provide overviews of company financials, geographical spread, affiliates of global unions and wages across countries. **Scan the QR code below for the database.**

These reports can be read using this guide to understand the key terms reported on. An example of this is when companies cite declining profit as reasoning for not increasing wages.

SCAN THIS QR CODE TO OPEN THE MNC DATABASE

SCAN THIS QR CODE TO SEE THE PREVIOUS GUIDE

[1] http://database.lrs.org.za/mnc/

01 Annual Financial Statement

Let's start at the beginning. What is an annual financial statement/report and why do companies publish them?

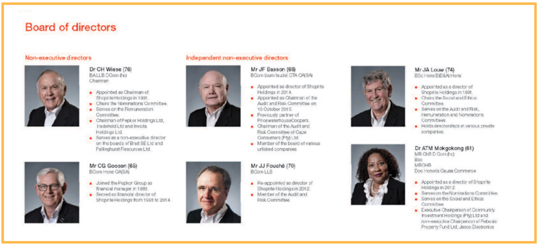
Companies that are listed for example on the Johannesburg Stock Exchange (JSE) are obliged to provide annual financial statements detailing the activities of the business, the expenses, and transactions, as well as give investors and the public an oversight of their financial state.

It's important to note the difference between a company's Integrated Annual Report (IAR) and Financial Report (FR), since many companies produce both. The IAR presents top-line financials, while the FR shows in-depth financial results for the financial year in question.

FOR THE PURPOSE OF THIS GUIDE, WE USED SHOPRITE'S IAR.

Executive and non-executive directors 02

Who are the executive and non-executive directors of a company? The executive directors are the leaders at the helm of a company. The Executive Directors sit on a board with other directors, and together they make decisions on how to run the company.



Executive directors do not only sit on the board – they also have management responsibilities within the company. **Non-executive directors** only take part in the top-line decision making. They do not interfere in day to day management of a company.

Non-executive directors play a dual role: firstly, to provide strategic and business insight and direction along with the executive directors; and secondly to monitor the executive directors and act 'in the interest of stakeholders.'[2] Generally, executive directors get paid significantly more than non-executive directors.

[2] https://www.investopedia.com/terms/n/non-executive-director.asp

03 Revenue

The value we add | Outputs and outcomes of our business model

Shareholders and funders

- Conservative capital allocation
- Sustained margins
- Sustainable long-term shareholder value

R145.3 billion turnover	R8.0 billion trading profit	R5.4 billion headline earnings	R2.9 billion declared dividends	5.5% trading margin

The term ‘revenue’ is one of the most used terms when talking about company finances. Companies may refer to revenue, trading profit or even company performance. This term is often linked to the financial term the company has operated in. For example, Shoprite’s financial year is from 1 July 2017 to 1 July 2018[3]. Revenue is, simply put, the amount of money taken in by the company during this specified time frame.

04 Operating Costs

Operating costs or expenses are what a company has to spend to keep itself functioning. It includes expenses like rent, salaries, buying stock, marketing, electricity and water – all the costs of running a business. Companies aim to keep these costs low in order to remain financially stable. Some costs are fixed, like rent, while others are variable, like labour costs.

Summary consolidated statement of comprehensive income

Shoprite Holdings Ltd and its subsidiaries for the year ended 1 July 2018

	Notes	% change	52 weeks 2018 Rm	52 weeks 2017 Rm
Sale of merchandise		3.1	145 306	141 000
Cost of sales		3.2	(110 580)	(107 174)
Gross profit		2.7	34 726	33 826
Other operating income		6.3	2 779	2 615
Depreciation and amortisation		16.3	(2 530)	(2 176)
Operating leases		11.9	(4 272)	(3 819)
Employee benefits		3.4	(10 851)	(10 498)
Other operating expenses		5.7	(12 494)	(11 821)
Net monetary gain			653	–

[3] Companies, for tax reasons, report on its finances yearly. In South Africa, the financial year normally ends on the last day of February. This serves as a standardised time frame within which companies report on their business and finance dealings.

Profit

05

Companies often state the profit made in a financial term, and it is valuable to know for bargaining purposes. Simply put, profit is revenue minus expenses. If the company made, say, ZAR5,000 in revenue, but it cost ZAR4,500 to run, the company only made a profit of R500. However, this also means that ZAR500 of the ZAR5,000 is profit, making for a 10% profit margin.

The sum looks something like this:

[revenue] – [operating costs] = [profit before tax]

([profit] / [revenue])*100 = [Profit Margin] %

Profit is often cited as 'profit before tax', and this number is subject to normal tax rates, depending on how the company chooses to structure its income. When companies refer to net profit or net earnings, they refer to profit after tax. Another way that companies refer to this number is the bottom line. This is the very last number on the financial report – after all of the costs and tax has come off (and that's where the name 'bottom line' comes from).

	Notes	% change	52 weeks 2018 Rm	52 weeks 2017 Rm
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Other operating expenses		5.7	(12 494)	(11 821)
Net monetary gain			653	–
Trading profit		(1.4)	8 011	8 127
Exchange rate losses			(251)	(236)
Items of a capital nature			(246)	(166)
Operating profit		(2.7)	7 514	7 725
Interest received		(4.9)	215	226
Finance costs		24.1	(422)	(340)
Share of profit of equity accounted investments			27	4
Profit before income tax		(3.7)	7 334	7 615
Income tax expense		(2.7)	(2 121)	(2 180)
Profit for the year		(4.1)	5 213	5 435

In the simplest of terms: net profit is what is left after the company has paid all of its bills.

06 Market share

What does a company mean when it refers to market share? The term reflects the percentage or portion of a market in a specified country that the company controls (in this case South Africa).

Let's say the retail market is made up of 100 – which means all the items bought (total sales) in retail in one year equals 100. If Shoprite sells 31.7 out of 100, that means they control 31.7 % of the market. The bigger the share, the more control the company will have in its given market. In this example, we know that Shoprite holds a lot of control over the pricing of lower priced goods because they hold a large market share.

Customers

- Trusted brands
- Affordable food
- Best value
- A world-class trading environment

31.7% RSA market share

Dividends & Interest

07

Big companies like Shoprite often mention dividends and interest in their financial reporting. Dividends refer to the amount of money paid back to investors as a percentage of their original investment. If I own 30 shares in Shoprite, the above sentence implies that for the financial year I will be paid 484 cents x 30 which equals ZAR145,20.

Distribution to shareholders

Ordinary dividends

An interim cash dividend (no 138) of 205 cents per share was paid on 19 March 2018. A final dividend (no 139) of 279 cents per share, is payable on 10 September 2018, bringing the total dividend for the year to 484 cents (2017: 504 cents) per ordinary share.

WHAT ARE SHAREHOLDERS?

Just like unions have members to answer to, companies have shareholders to answer to. A shareholder is any person, company, or institution that owns at least one share of a company's stock.

Essentially, these shareholders are part owners of the company. If the company does well, shareholders are paid a part of the profit, and if the company does badly (if the profit goes down), shareholders lose money. Shareholders will put pressure on the board to lower operating costs – in order to increase profit[4]. *Scan QR to read more about this.*

[4] https://www.investopedia.com/terms/s/shareholder.asp

Operating profit	(2.7)	7 514	7 725
Interest received	(4.9)	215	226
Finance costs	24.1	(422)	(340)
Share of profit of equity accounted investments		27	4

SO, THEN, WHAT IS INTEREST? If Company X borrows money from the bank, it pays back interest along with the original amount borrowed. Basically, Company X is paying to borrow money. Similarly, when customers buy from Shoprite on credit it means that when they pay back this money, they are paying back an additional amount in interest. In this way, Shoprite makes money from extending credit to its customers.

08 Assets

Companies have what are called assets. Assets are economic resources – this includes everything the company owns that has monetary value: anything from office furniture and buildings to unsold products on shelves, or trademarks and copyright the company owns. Assets have 'inherent cash value.'[5] This means that if the company is sold, these assets are counted towards the value of a business.

	Notes	2018 Rm	2017 Rm
Assets			
Non-current assets		29 352	24 572
Property, plant and equipment	3	21 218	18 407
Equity accounted investments		–	27
Held-to-maturity investments	4	2 090	1 311
Loans and receivables	5	1 318	1 110
Deferred income tax assets		876	859
Intangible assets		2 994	2 355
Trade and other receivables		856	503
Current assets		32 306	31 032
Inventories		17 959	17 794
Trade and other receivables		4 931	5 105
Derivative financial instruments		–	1
Current income tax assets		120	154
Held-to-maturity investments	4	1 600	–
Loans and receivables	5	231	211
Cash and cash equivalents		7 465	7 767
Assets held for sale		184	119
Total assets		61 842	55 723

[5,6] https://www.nationalfunding.com/blog/basic-business-financial-terms/

Liabilities

09

Just like companies have assets, they also have liabilities. Liabilities are the opposite of assets. This can include loans from the bank, or money owed to vendors. One type of liability is debt, and another type is 'bills' or 'accounts payable'.[6]

Assets are sometimes also referred to as capital. To calculate 'working capital' or equity, a company does the following sum:

[ASSETS] – [LIABILITIES] = [WORKING CAPITAL] OR [EQUITY]

Liabilities			
Non-current liabilities		3 567	1 492
Borrowings	7	1 371	–
Deferred income tax liabilities		697	96
Provisions		264	232
Fixed escalation operating lease accruals		1 235	1 164
Current liabilities		30 798	26 482
Trade and other payables		20 621	17 414
Borrowings	7	5 606	3 274
Current income tax liabilities		481	582
Provisions		95	154
Bank overdrafts		3 995	5 058
Total liabilities		34 365	27 974
Total equity and liabilities		61 842	55 723

Equity			
Capital and reserves attributable to owners of the parent			
Share capital	6	–	681
Share premium		–	8 585
Stated capital	6	7 516	–
Treasury shares	6	(554)	(446)
Reserves		20 424	18 838
		27 386	27 658
Non-controlling interest		91	91
Total equity		27 477	27 749

10 Depreciation and Amortisation

Financial highlights

	% increase/ (decrease)	52 weeks 2018 Rm	52 weeks 2017 Rm
Sale of merchandise	3.1	145 306	141 000
Trading profit	(1.4)	8 011	8 127
Earnings before interest, income tax, depreciation and amortisation (EBITDA)	1.0	10 114	10 013
Profit before income tax	(3.7)	7 334	7 615
Basic headline earnings	(2.8)	5 398	5 554
Performance measures			
Diluted headline earnings per share (cents)	(3.8)	968.7	1 007.4
Dividends per share declared (cents)	(4.0)	484.0	504.0
Dividend cover (times)		2.0	2.0
Trading margin (%)		5.5	5.8
Return on average shareholders' equity (%)		16.5	19.4

Depreciation of assets is something that happens over time – so, as with some of our other terms, depreciation is something looked at over a financial term. In Shoprite's case, depreciation is measured over the financial year. Most physical assets, like office furniture, trucks, stock and furniture in the store (like tills and shelves) lose value over time. As these items get older, they hold less financial value than when they were initially bought.

LET'S TAKE THE EXAMPLE OF AN OFFICE CHAIR.

Company X buys an office chair to the value of ZAR1,000 in 2012. In 2012, Company X can sell this chair for the same approximate value should the company need money. However, by 2019, when the chair is 7 years old, used and out of fashion, Company X can only sell the chair for R300. This is the depreciation of assets over time. Companies need to account for depreciation when valuing their assets.

Along with the term depreciation we often find the term amortisation. **Amortisation** refers to 'debt getting smaller'.

LET'S TAKE A LOOK ANOTHER EXAMPLE.

In 2012, company X took out a loan from the bank to the value of ZAR1,000. Every month, Company X pays off small amounts to cover this debt. By 2013, Company X has paid off half of the debt, which means the debt (or liability) is now only ZAR500. This is the amortisation of debt over time.

Valuation and Devaluation 11

The term valuation links back to the term we talked about above: assets. When a company is determining its 'overall worth', it needs to value its assets. How much is the company worth? Potential investors are also interested in this number. By valuing assets and knowing what each asset is worth, companies are able to determine their monetary worth.

Often linked to valuation is devaluation – a term similar to depreciation. You'll come across this term typically when referring to currencies. In the case below, Shoprite had expected to earn a certain amount of income in Angola. However, the currency is now worth less when compared to ZAR and Shoprite has thus earned less revenue.

> **Hyperinflation**
> The currency devaluation in Angola, together with high levels of consumer inflation over the past three years, has resulted in a requirement for the Shoprite Group to account for the results of its Angola operations on a hyperinflationary basis in accordance with IAS 29 (Financial Reporting in Hyperinflationary Economies) from 3 July 2017.

12 Cash flow

Companies often refer to the term 'cash flow' in their financial reporting. It is the 'overall movement of funds each month, including income and expenses.'[7] Cash flows in from paying customers and flows out again through expenses like rent and accounts payable. It's important for companies to keep track of their cash flow, as this determines whether there will be enough money available to pay off any outstanding debts timeously.

Summary consolidated statement of cash flows

Shoprite Holdings Ltd and its subsidiaries for the year ended 1 July 2018

	Notes	2018 Rm	2017 Rm
Cash flows from operating activities		7 418	3 339
Operating profit		7 514	7 725
Less: investment income		(344)	(189)
Non-cash items	11.1	2 919	3 089
Changes in working capital	11.2	2 686	(2 278)
Cash generated from operations		12 775	8 347
Interest received		493	399
Interest paid		(555)	(416)
Dividends received		49	16
Dividends paid		(2 980)	(2 595)
Income tax paid		(2 364)	(2 412)

13 Credit (CR)

The term credit is widely used. Credit will either 'decrease assets or increase liabilities and equity on the company's balance sheet.'[8] If Company X is given credit, it means that an entity has allowed them to use money without paying for it immediately. So, if Company X is given credit of ZAR1,000, it means it has added ZAR1,000 to its list of liabilities.

[7] https://quickbooks.intuit.com/r/financial-management/15-financial-terms-every-business-needs-to-know/

[8,9] https://www.rasmussen.edu/degrees/business/blog/basic-accounting-terms-acronyms-and-abbreviations-students-should/

Debit (DR) 14

Debit, on the other hand, is when there is an 'increase in assets or a decrease in liabilities'[9] – for example, someone has paid Company X ZAR1,000 for services or goods rendered, and this shows as a positive amount in Company X's bank account.

Return on investment (ROI) 15

You'll often come across the term Return on Investment or ROI. Sometimes this is referred to as 'return on average shareholder's equity', as we can see in Shoprite's Annual Report below. We can use this term to determine the financial performance of the company. 'ROI tries to directly measure the amount of return on a particular investment, relative to the investment's cost.'[10] In order to calculate the ROI, the benefit of the investment is divided by the cost of the investment. So, if I invest R1,000 into Shoprite, and the ROI is 16.5%, that means I got back 16.5% of the money I put in (ZAR165). The higher this percentage is, the more money the company has made in profit.

Performance measures			
Diluted headline earnings per share (cents)	(3.8)	968.7	1 007.4
Dividends per share declared (cents)	(4.0)	484.0	504.0
Dividend cover (times)		2.0	2.0
Trading margin (%)		5.5	5.8
Return on average shareholders' equity (%)		16.5	19.4

[10] https://www.investopedia.com/terms/r/returnoninvestment.asp

How to use this knowledge in collective bargaining contexts

Most companies' biggest operating cost is employee salaries and wages. In order to keep profit high, companies try to keep operating cost low. The employer will attempt to obscure financial information in order to secure their position in bargaining. By being able to interpret financial reporting, unions can accurately interpret company finances in order to strengthen their bargaining position.

By knowing company revenue and profit, as well as other key terms as described in this guide, negotiators are able to negate companies' claims of lowered profit being the reason for not being able to 'afford' certain increases. When negotiators are aware of the actual financial position of the company it is bargaining with, they have a more realistic view of the wage increases that can be expected from the company.

Resources

1. https://quickbooks.intuit.com/r/financial-management/15-financial-terms-every-business-needs-to-know/
2. https://www.investopedia.com/terms/r/returnoninvestment.asp
3. https://www.nationalfunding.com/blog/basic-business-financial-terms/
4. https://www.rasmussen.edu/degrees/business/blog/basic-accounting-terms-acronyms-and-abbreviations-students-should/
5. https://www.nationalfunding.com/blog/basic-business-financial-terms/
6. https://www.news18.com/news/business/with-budget-2019-later-this-week-key-financial-terms-you-must-know-2017739.html
7. https://www.investopedia.com/terms/r/returnoninvestment.asp

FURTHER READING

MNC Trend Report 2018 - South African Multinational Corporations in Africa. Available in English, French and Portuguese. Click here: *https://www.fes-tucc.org/publications/seite/1/*

LRS MNC Database: *http://database.lrs.org.za/mnc/*

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Notes

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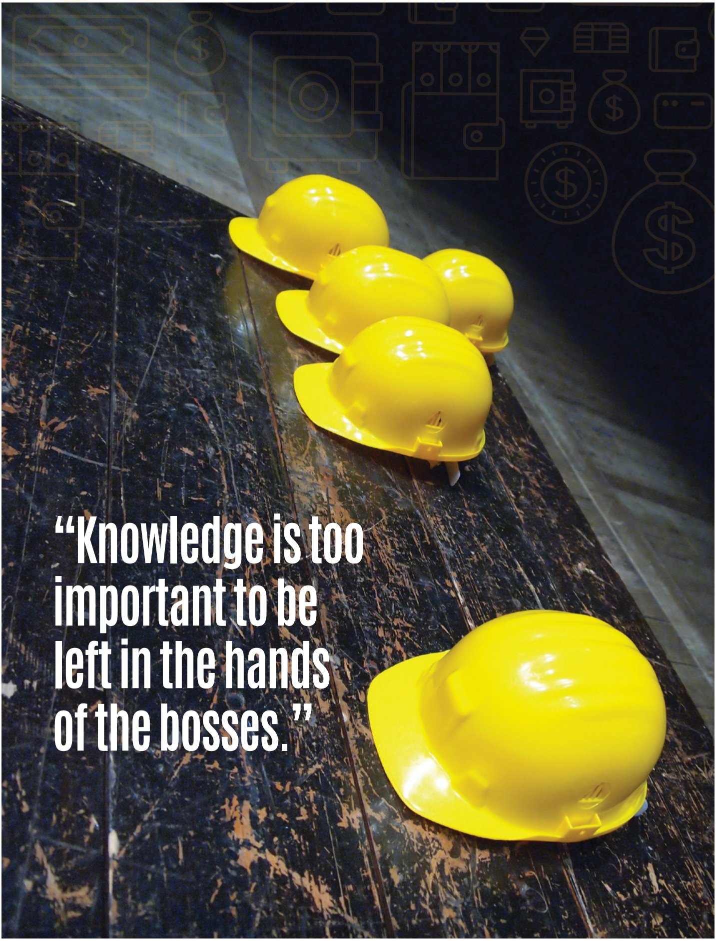

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