CHARTA LEARNING · INTERVIEW PREPARATION

Financial Statements and Accounting for Finance Teams

Interview preparation summary · FP track

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INT.FS.1.a · The statements

Trace a transaction through the income statement, balance sheet and cash flow statement and explain why profit and cash differ.

The income statement reports performance over a period: revenue less costs gives profit. The balance sheet shows at a date what the company owns (assets), owes (liabilities) and what belongs to the owners (equity), and it always balances. The cash flow statement explains why cash moved, usually starting from profit, adding back non-cash charges such as depreciation, adjusting for changes in working capital, and then showing investing and financing flows. The statements link: profit increases retained earnings in equity, depreciation reduces both profit and the asset, and a credit sale raises profit and receivables before any cash arrives. Because profit follows the accrual basis, a profitable company can still run short of cash when customers pay slowly, stock builds or it buys equipment. Interviewers ask you to trace one transaction through all three statements or to explain a profit and cash gap. A strong answer states the double entry, names each statement touched and checks that the balance sheet still balances. The usual mistake is to treat depreciation as a cash cost or to forget the working capital movement.

WORKED EXAMPLE: ONE MONTH AT TARNSIDE PACKAGING: PROFIT OF 78 AND NO CHANGE IN CASH

Tarnside Packaging is an invented maker of cartons. Figures are in GBP thousands. Opening balance sheet: cash 150, receivables 100, inventory 200, equipment 500; payables 120, equity 830. In the month it sells goods for 400 on credit that cost 240 from inventory, buys more inventory for 150 on credit, pays wages and overheads of 80 in cash, buys equipment for 120 in cash (depreciated over 60 months), collects 300 from customers and pays suppliers 100. Work out profit, the closing balance sheet and operating cash flow. Ignore tax and interest.

Answer: Profit is 78 and cash is unchanged at 150. The balance sheet totals 1,078 on both sides, operating cash flow is 120 and the equipment purchase of 120 absorbs it.

> **Interview tip:** Say it as a sequence: the sale lifts profit and receivables, collection lifts cash, depreciation hits profit but not cash, and equity ties the income statement to the balance sheet. Finish by saying the balance sheet balances.

INT.FS.1.b · The statements

Explain at overview how revenue is recognised, including performance obligations, deferred revenue and the difference between revenue and cash received.

Revenue recognition under modern frameworks such as IFRS and US GAAP follows a common idea: recognise revenue when, or as, the company satisfies a promise to the customer by transferring control of a good or service, for the amount it expects to be entitled to. In outline, identify the contract, identify the separate promises (performance obligations), set the price, allocate the price across the promises in proportion to their stand-alone prices, and recognise revenue as each promise is met, either at a point in time (a delivery) or over time (a subscription or a long project). Cash received before the promise is met sits on the balance sheet as a contract liability, often called deferred revenue. Cash received late sits as a receivable. FP&A teams care because revenue, billings and cash are three different numbers and each tells a different story. Interviewers test whether you can compute revenue for a partly delivered contract. Common mistakes are to recognise revenue when cash is received or when a contract is signed, and to forget that a discount in a bundle is shared across its parts. Practice varies, so state your assumptions.

WORKED EXAMPLE: A BUNDLED CONTRACT AT BRACKENFIELD SYSTEMS

Brackenfield Systems is an invented supplier of workshop equipment. On 1 October it sells equipment and a 12-month service package to one customer for 114 in total (GBP thousands), invoiced and paid in full that day. Sold separately, the equipment is priced at 100 and the service at 20. The year-end is 31 December and the equipment is delivered on 1 October. How much revenue is recognised in the year, and what is on the balance sheet at 31 December?

Answer: Revenue for the year is 99.75 (95 for the equipment plus 4.75 for three months of service), and deferred revenue at 31 December is 14.25.

> **Interview tip:** Say the three numbers in order: cash 114, revenue 99.75, deferred revenue 14.25, and explain that the difference is service still owed to the customer. State that you allocated the discount by stand-alone prices.

INT.FS.1.c · The statements

Calculate EBITDA and an adjusted EBITDA, and explain its limits as a measure of cash and performance.

EBITDA is earnings before interest, tax, depreciation and amortisation, usually built up from operating profit by adding back depreciation and amortisation. Teams use it to compare operating performance across companies with different debt and asset bases, and lenders use it in leverage ratios. Its limits matter more than its definition. It ignores capital expenditure, so a heavy investor and a light one can show the same EBITDA with very different cash. It ignores working capital, tax and interest actually paid. It moves with accounting choices: capitalising a cost raises it, and lease accounting that replaces rent with depreciation and interest raises it too. Adjusted EBITDA adds back items management calls one-off, such as restructuring or disposal gains, and a good analyst asks whether each item really is non-recurring, whether it was a real cost, and whether the same item appeared in earlier years. Interviewers want you to compute it, then challenge it. The usual mistake is to treat EBITDA as cash flow or to accept every add-back without question.

WORKED EXAMPLE: ADJUSTED EBITDA AND CASH AT KESTRELOW COMPONENTS

Kestrelow Components is an invented manufacturer. Figures are in GBP millions. Operating profit is 18.0 after depreciation of 6.5 and amortisation of 1.5. Operating profit includes a restructuring charge of 3.0 and a gain on sale of a spare warehouse of 2.0. Capital expenditure was 9.0, working capital rose by 2.5 and lease payments were 4.0. Compute EBITDA, adjusted EBITDA and how much of adjusted EBITDA became cash, and say what you would challenge.

Answer: EBITDA is 26.0 and adjusted EBITDA is 27.0, but only 11.5 (42.6 percent) remains after capital expenditure, working capital and lease payments, and recurring restructuring would argue for a lower underlying figure.

> **Interview tip:** Give the number, then the challenge: say what EBITDA leaves out and ask whether each add-back has happened before. Offering both the adjusted figure and the cash figure shows judgement.

INT.FS.2.a · Judgement areas

Compare inventory costing methods, apply the lower of cost and net realisable value, and explain how inventory choices change cost of sales and profit.

Inventory sits on the balance sheet at cost until it is sold, when its cost moves to cost of sales. When purchase prices change, the cost method decides which prices reach profit. First in, first out (FIFO) assumes the oldest units are sold first, so in a period of rising prices it gives a lower cost of sales, a higher profit and a higher closing inventory. Weighted average smooths prices and lands between the two. Practice varies by framework. Whatever the method, inventory is carried at the lower of cost and net realisable value (NRV), which is the expected selling price less the costs needed to complete and sell it, so stock that will sell below cost is written down in the period the problem is spotted. Interviewers ask what a rising inventory balance might hide, such as slow-moving or obsolete stock. The usual mistakes are to ignore the write-down and to forget that total cost over the life of the stock is the same whichever method is used.

WORKED EXAMPLE: FIFO, WEIGHTED AVERAGE AND A WRITE-DOWN AT LARKHAVEN TOOLS

Larkhaven Tools is an invented distributor. It starts the period with 100 units that cost 10 each. It buys 200 units at 12 each and sells 150 units at 20 each. Compare cost of sales, gross profit and closing inventory under FIFO and weighted average, then test the closing inventory if the expected selling price falls to 11 each with 1 of selling cost per unit.

Answer: FIFO gives cost of sales 1,600 and gross profit 1,400, weighted average gives 1,700 and 1,300, and an NRV test at 10 per unit writes closing FIFO inventory down by 300 to 1,500.

> **Interview tip:** Say that the method moves cost between periods without changing the total, then name NRV as the safeguard. Ask for an ageing report when inventory grows faster than sales.

INT.FS.2.b · Judgement areas

Decide whether to capitalise or expense a cost, work out the profit effect of depreciation choices, and explain provisions and leases at overview.

Capitalising a cost means recording it as an asset and charging it to profit gradually through depreciation or amortisation; expensing it charges the whole amount at once. The test is whether the cost creates a controlled resource with future benefits that can be measured reliably: buying a machine qualifies, routine repairs do not, while development spending qualifies only once conditions such as technical feasibility are met and research does not. The choice moves profit between years, not cash, and lifts EBITDA because the charge moves below that line. Depreciation spreads cost less residual value over useful life, and a change of estimate, such as a longer life, applies to the future rather than restating the past. A provision is a liability of uncertain timing or amount, recognised when an obligation exists, an outflow is probable and the amount can be estimated reliably; a possible obligation is usually disclosed only. At overview, many lessees record a lease as an asset and a liability at the present value of payments, with depreciation and interest replacing rent. Practice varies by framework. Interviewers test the profit effect and whether you spot aggressive choices.

WORKED EXAMPLE: CAPITALISING DEVELOPMENT COST AT WEXCOMBE DEVICES

Wexcombe Devices is an invented medical equipment maker. In year 1 it spends 2.4m (GBP) on a new product. Of this, 0.6m is research and 1.8m meets the conditions for capitalising as development cost. The product launches at the start of year 2 and the capitalised cost is amortised straight line over 4 years. Compare the effect on operating profit, EBITDA and cash in years 1 to 5 if the full 2.4m is expensed instead.

Answer: Capitalising lifts year 1 operating profit and EBITDA by 1.8m, lowers each of years 2 to 5 operating profit by 0.45m, leaves the five-year total and cash unchanged, and shifts 1.8m of cash outflow from operating to investing.

> **Interview tip:** Say that accounting policy changes the timing of profit, not the cash, and name two questions you would ask: were the criteria met, and is the life realistic.

INT.FS.2.c · Judgement areas

Work through month-end accruals, prepayments and depreciation journals and explain how a close process protects accuracy.

The month-end close is the routine that turns raw transactions into reliable management accounts. Finance teams post depreciation, accrue costs for goods and services received but not yet invoiced, release prepayments (costs paid in advance, held as an asset until used), recognise revenue earned but not billed or deferred where cash came first, reconcile bank and ledgers, review variances and lock the period. A journal always has equal debits and credits. An accrual debits an expense and credits a liability; a prepayment release debits an expense and credits the prepayment asset; depreciation debits an expense and credits accumulated depreciation. Many teams reverse accruals at the start of the next month so the actual invoice replaces the estimate, and any difference is the true-up. Interviewers ask you to write a journal and explain the effect on profit, and to describe what you would do on finding an error after the close, usually by correcting it in the current period if immaterial and telling the controller. The common mistakes are one-sided entries, double counting an accrual and its invoice, and forgetting the reversal.

WORKED EXAMPLE: A MONTH-END CLOSE AT ALDERBANK FOODS

Alderbank Foods is an invented food processor. At 31 October it must book three items. Electricity used in the month was 24,800 units at 0.19 each and the invoice has not arrived. An annual insurance premium of 18,000 was paid on 1 October and recorded as a prepayment. Annual depreciation on its equipment is 240,000. Draft the journals, the effect on October profit, and what happens when the electricity invoice for 4,790 arrives in November after the accrual is reversed.

Answer: October expenses rise by 26,212 (4,712 accrual, 1,500 insurance and 20,000 depreciation), and the electricity true-up in November is a charge of 78 after the accrual reversal.

> **Interview tip:** Say the debit and credit aloud for each journal, then give the profit effect and say what is cash and what is not. Mention the reversal so the cost is not counted twice.