



USERS OF ACCOUNTING INFORMATION



Learning Objective

- To define external and internal users of accounting data




Key Understanding

- Understanding of the external and internal users of accounting data to know the type of information needed by the users.

Key Question


- Who are the external and internal users of accounting data?



External Users

CUSTOMERS


- *Customers* are the main source of income of businesses. It can even be claimed that most businesses are established solely for the service of their customers.
- Businesses usually aim to widen their reach by targeting multiple customers segments.
- All of us have been a customer at some point in our lives. When you bought shampoo in the nearby *sari-sari store*, you are considered a customer.
- It is important to point out that even large businesses can be customers.
- Simply put, *customers* are people or entities that acquire goods and services for a fee.



External Users

CUSTOMERS


- Customers are one user group that is particularly interested in the accounting information of a business. By analyzing the accounting information of a business, customers can determine if it will be profitable for them to transact with the business.
- Normally, customers note a company's income, which is a good indicator of the profitability of a company. A profitable result of operations is a signal that the customers will take minimal risk if they decide to deal with the company. Occasionally, customers also try to know the future commitments of the company (e.g., plans for expansion of the business or to discontinue a business segment) since it will affect their long-term plans as well.
- Another thing customers look for in the company's financial report is its capabilities to honor obligations (e.g., warranties and after-sales services).



External Users

Example: Patricia plans to organize a furniture shop. She wants her business to take off by building the furniture from scratch. However, the materials needed to build the furniture will be purchased from an outside supplier. Patricia has two possible suppliers: Dayana Company and Dray Company. For the last 5 years, Dayana Co. and Dray Co. displayed positive income in their financial statements with Dray Co. having a slightly higher income on the average than Dayana Co.'s. Both companies are regarded as reliable suppliers. But during the last year, Dray Co. experienced problems in its operations due to a labor strike preventing it from fulfilling all orders. What company should Patricia choose as her supplier?


Based on the facts given, Patricia should choose Dayana Co. as her supplier. Even though Dray Co.'s income is slightly higher on the average than Dayana Co.'s, the reliability of Dayana Co. is the more important factor to consider. Since the operation of Dayana Co. is stable, it will likely be the more stable supplier.



External Users


CREDITORS

- *Creditors* lend their resources (usually money) to the business in exchange for a fee. The fee charged by creditors is the payment for the use of their resources.
- Before creditors grant loans to a business, they first examine its financial statements. The biggest fear of creditors is that they will not get paid the amount due to them.
- Creditors would not lend to a risky company. However, there are creditors who still offer their money to these companies in exchange for higher interest rates or lending fees. As a rule of thumb in the field of finance, "high risk, high return."



External Users

- Three main factors considered by creditors before lending to a company:
 1. **Riskiness of lending**
 2. **Profitability of the company**
 3. **Company's amount of borrowings**




External Users

Example: Amadeo. Co., a textile manufacture, submitted a proposal to Philippine Rural Bank (PRB) which states that the company plans to borrow ₱5M payable two (2) years from now. Amadeo Co. also promises to pay interest of ₱150 000 every six months. PRB examined Amadeo Co.'s financial statements. Based on the bank's analysis, they formed the following conclusions:

1. The profit of Amadeo Co. grew by an average of 10% each year for the past 3 years.
2. Amadeo Co. only has a small amount of borrowings.
3. Amadeo Co. never defaulted on its borrowings in the past.


Assuming no other use for its excess funds, should PRB lend money to Amadeo Co.? The answer is yes. The conclusions showed that lending to Amadeo Co. is not a risky endeavor.



External Users

POTENTIAL INVESTORS


- Like creditors, *investors* may also provide the additional fuel to drive the company forward by putting their resources (usually money) in a business hoping to earn a decent amount of return. Unlike creditors who are assured to earn the interest and fees, investors may win or lose in their investment. Investing in a business is a gamble.
- To compensate investors for the risks they take, they normally could earn more profits than creditors. Creditors earn fixed amount of profits in the resources they lend (i.e., interest and fees). Investors, on the other hand, enjoy no limit on the amount of profits they can receive. If the company you invest in is doing well, expect a large amount of profit. If the company you invest in incurs a loss, you might even lose everything you invested.
- Everyone can be an investor as long as one has enough resources to place in the company's stewardship. Investors are mostly wealthy individuals, but businesses can invest in other businesses as well.



External Users

POTENTIAL INVESTORS


- Financial statements provide *potential investors* the necessary information to decide if they will invest in the business.
- The level of profits presented in the financial statements is a primary concern for investors. This information is a key indicator if an investment will be profitable.



External Users

Example: Aryana is a successful career woman. During her 15-year tenure as an engineer, she amassed a total of ₱10M in savings. Instead of placing her money in the bank, which earns only 2% in interest every year, she plans to invest in either Shell or Petron. Shell and Petron are two of the largest oil companies in the country. After analyzing the financial statements of both companies, Aryana noted that Petron and Shell earned high levels of profit for the past 2 years with Petron garnering Php40M more in profits. In addition, Petron is planning to expand the business which is expected to bring in more profits for the company.

Based on the facts given, it is more probable that an investment in Petron will be the more profitable investment in the long run. As illustrated in this example, both the company and the investor will benefit from the communication of accounting information. Investors can make better informed decisions while companies can attract potential investors to provide additional funds.



External Users

GOVERNMENT

- The *government* is likewise a user of a company's financial statements, primarily to *regulate the businesses in the economy*, but can also invest in or lend money to businesses.
- The government, particularly the taxing authorities, also uses the financial statements to compute for the amount of taxes payable by a company. Companies' desire to pay lower taxes might encourage them to understate revenues and overstate expenses to the detriment of the public. Taxing authorities guarantee that this wrongdoing does not occur.
- The government particularly looks at the income, revenues, and expenses of a company. Officials want to ensure that companies do not overstate their income to attract more investors and creditors. Investing huge amounts of money in a company with lower than perceived value can be very harmful for the economy. Revenues and expenses are closely scanned for taxing purposes.



External Users

Example: The Bureau of Internal Revenue (BIR) is responsible for the assessment and collection of taxes from its constituents. As you probably heard in the news, BIR is strengthening its collection policies to provide more funds for the government to use. In the BIR, tax assessors and tax collectors study the financial statements of the companies and compare them with filed tax returns. If the tax returns do not match to the results of the financial statements, the BIR computes for the appropriate taxes to be collected.



External Users

ACADEME

- Although they do not usually transact with businesses, members of the *academe* (e.g., professors, researchers, students) utilize financial statements for academic purposes.
- Financial statements also serve as a blueprint to help students in understanding the field of accountancy.
- Researchers study the financial statements to identify particular trends in a specific industry or the economy as a whole. The result of the studies conducted by researchers can greatly help the government in assessing the condition of the economy.
- Researchers may also aim to improve the accountancy practice in the country by searching for loopholes and possible improvements in the accounting standards currently being used.



External Users

Example: Zed is currently enrolled in a BSA program in the Philippines. For his project, he was tasked to report on the condition of the consumer goods industry in the country. He must also explain how the businesses in the industry operate.

To accomplish his project, Zed can take a look at the financial statements of some businesses like Procter & Gamble and Unilever. Being the top two businesses in the industry, the performance of P&G and Unilever is a good indicator of the condition of the industry. The nature of the operations of these businesses can also be seen in their financial statements.



External Users

PUBLIC

- The general *public* is the last group considered to be an external user.
- Companies undoubtedly affect the whole economy. By continuing to operate, companies create jobs for the public. The results of company operations also pull the economy towards growth or recession. Financial statements give us hints about the condition of the economy. If the economy is not doing well, the general public cut on their spending and increase their savings. The contrary is true if the economy is prosperous. By analyzing the financial statements of companies, the public can properly respond to the various economic cycles.



External Users

PUBLIC


- The public's behavior concerning their levels of consumption and spending is not the only thing affected when they study financial statements. Since financial statements taken together can represent the economy, other decisions of the public that can be affected involves:
 1. Whether or not it is wise to start a business given the current economic conditions;
 2. To stay on a current job or look for a higher-paying job;
 3. Determining the best use of a person's resources (i.e., where to put your money); and
 4. Determining the optimal level of savings and consumption.



Internal Users

MANAGEMENT


- *Management* is composed of employees within the company that can implement decisions affecting the company's operations, such as members of the board of directors, top management, middle-level managers, and supervisors are the common classes of employees belonging to the management group. They will be referred to here as "managers."
- All managers must know the company inside and out. By examining financial statements, managers are able to identify problems and respond to them accordingly.



Internal Users

MANAGEMENT


- Some problems faced by managers include, but is not limited to, the following:
 1. What areas of the business are becoming problematic?
 2. What segments of the business underperformed during the last period? What is the cause of such underperformance?
 3. Is the level of company expenses becoming alarming?
 4. How does the company handle its debt? Is the company incurring too much borrowing that will be difficult to pay in the long run?
 5. Does the company use its resources in the best possible way?



Internal Users

Example: Fix It Beauty Salon is one of the largest and most successful salons in the country. For the past 5 years, Fix It earned significant amounts of profits. Financial statements from the previous year indicated a net income of ₱10M. During the first quarter of the ensuing year, revenues of the company are well below budgeted amounts. The first quarter's poor performance alarmed the owners, so they ask Mr. Louie Tan, head of company operations, to identify and solve the problem.


By examining the financial statements, Mr. Tan noticed that 10 out of 25 branches of Fix It had revenues below the budget. He also noticed that the marketing and advertising expenses of these branches were also materially below the budget. He found out that managers of these branches cut on the advertising expense in hopes of improving the net income figure. This plan obviously backfired since revenues lost are greater than the savings from marketing and advertising. Mr. Tan immediately ordered the managers of these branches to follow the proposed advertising expense in the next quarter.



Internal Users

EMPLOYEES

- Other *employees* of a business, aside from managers, sometimes take a look at the company's financial statements. Unlike managers who examine the financial statements to make better decisions for the benefit of the company, other employees use them primarily for personal reasons.
- Employees are concerned with the company's profitability. If the company they are working for is profitable, employees feel that they will timely and adequately receive their compensation and additional benefits.
- The current condition of a company also impacts employee morale and performance. Companies that are performing well almost always have employees that are motivated. On the other hand, employee demotivation might be the effect of not meeting company goals.



Internal Users

OWNERS OR STOCKHOLDERS

- *Owners or stockholders* are the existing investors of the company. Some owners or stockholders take an active role in the management of the business while others just wait for the generation of profits. Whatever their role in the business might be, all owners or stockholders are interested in the results of company operations.
- Predominantly, owners or stockholders want to know if their investments will yield acceptable returns. A profitable business keeps its investors happy. As a result, investors would not liquidate their ownership, but might even provide additional resources while the business is enjoying success. Meanwhile, businesses who fail to achieve desired profit levels usually result in dissatisfied owners or stockholders.

