Impact of finances on financial statements

Business

IMPACT OF FINANCES ON FINANCIAL MENTS The management of a company is highly dependent on the control of finances in order to ensure there is an optimal mix of debt and capital in the company. Financial statements give a record of all the financial undertakings and include profit and loss account and the balance sheet (and the cash flow statement). An influx of funds affect the shape of the income statement as it seeks to indicate the profit generated by the company based on expenses and incomes of the company. When there is a lot of cash in the business, the income will increase which will also lead to an increase in the expenses. However, the increase in revenue may not necessarily lead to the proportionate increase in profits when the cash is excess to the point of exceeding the optimal capital mix. The influx of funds also affects the shape of the balance sheet more as the balance sheet is responsible for recording assets and liabilities of the business as well as the capital and debt. As such, it is largely affected by the changes in equity from the upsurge of capital. When there is an increase in funds in the business, the total assets increase, but also the liabilities since both sides of the balance sheet have to balance. There will be more current assets than current liabilities which means that the business will have a lot of cash at hand in the short run. However, mismanagement of such funds and cost of long term loan will have a long term impact on the company’s balance sheet. This is because an influx of funds - loans, grants, share issue income, retained profits indicates an ease with which money enters the business which means that it is very easy also for the money to move out the business in the same way. While there are huge benefits to a company when it is sufficiently liquid, the volatility the influx of finances will bring forth to the company can be challenging as it requires improvement in the management practices (Brealy, Richard & Stewart, 2003). The influx of funds confronts management of companies with the need to limit the excessive liquidity in the company as this can lead to financial imbalances such as the prices of the long term assets. Moreover, if the funds are not properly managed, they can be increase the current and long term liabilities of the company. As such, organizations must be transparent about this by providing more information regarding the performance of the business so as to expose the type and extent of risks the company is facing with respect to the influx of cash. More information about the cash dealings increases transparency as well as certainty to the investors. When financial statements are prepared from fully updated reports, the company minimizes the risks that are unforeseen since interpretation of the data is made easier. It is prudent to note that companies that are always transparent are very eager to publicize their capital and earnings as it is a reflection of their performance. This enhances good financial conduct which prevents mismanagement of funds or unforeseen volatility (Brigham & Ehrhardt, 2005). ReferencesBrigham, E. F., & Ehrhardt, M. C. eds. 2005, Financial Management Theory and Practice. Ohio: South-Western. Brealy, Richard A., & Stewart C. M., eds. 2003. Principles of Corporate Finance. Boston: McGraw-Hill/Irwin.