Financial statements form and use essay

Business, Accounting

1.

Introduction – Preparation of Financial StatementsEvery limited liability company is required to prepare annual financial statements as prescribed by the Companies Act. Such financial reports ought to be public reports, which are filed with the Registrar of Companies. The financial statements basically entail an income statement, a statement of changes in equity, a balance sheet, a cash flow statement and accompanying notes. In this paper we shall explain the content of such reports, their order of preparation, their interrelation and use.

1. 1 Financial Statements Preparation and PresentationThe first report prepared is the Income Statement, which reveals the financial performance of the company for the financial year considered. As shown in the Generally Accepted Accounting Principles of the United States, the income statement consists of the following items: turnover; cost of sales; gross profit or loss; distribution costs; administrative expenses; other operating income; income from shares in group and associated undertakings; income from other financial assets; other interest receivable and similar income; interest payable and similar charges; corporate taxation; profit or loss on ordinary activities before after taxation; extraordinary income, extraordinary charges, extraordinary profit or loss; tax on extraordinary profit or loss; other taxes and profit or loss for the accounting period. This is the first financial report prepared because the net profit or loss derived from it is used in the other reports. Therefore one cannot for instance prepare the statement of changes in equity before in such statement one needs the determination of the profit or loss. The statement of changes in equity reveals the movements

in share capital, capital reserves and revenue reserves balances during the year.

Certain items affecting profit balances are included in this statement and not in the income statement as prescribed by the relevant laws and accounting standards. These basically include dividends to shareholders and transfers to other reserves. This is prepared before the Balance Sheet because the closing balances calculated in this statement are showed in the equity section of the balance sheet. However, in the financial statement of a company, the statement of changes in equity is presented after the Balance Sheet due to the importance that the latter statement have. In the balance sheet of a company one can see a picture of the assets, liabilities and equity of the firm. This sheds light on the financial position and capital structure of the corporation.

The Generally Accepted Accounting Principles of the United States list the following items, which are frequently shown in the Balance Sheet: ASSETSNon Current Assets·   Intangible Assets·   Property, plant and equipment·   Financial AssetsCurrent Assets·   Stocks·   Debtors·   Short-term investments·   Prepayments/Accrued income·   Cash at bank and in handLIABILITIESLong-Term Liabilities·   Debenture/Bank loan·   Provision for liabilities and charges (deferred taxation, contingent liabilities, etc)Current Liabilities·   Creditors·   Bank overdrafts and short-term loans·   Bills of exchange payable·   Accruals/Deferred IncomeEQUITYCalled up Issued Share Capital·   Ordinary Shares·   Preference SharesCapital and Revenue Reserves·

Share premium· Revaluation reserve· Retained earnings· Other reservesCash flow statement is the last statement prepared in the financial statements before the accompanying notes. This financial report accounts for the movement in cash and cash equivalents during the year. There are two methods through which a cash flow statement can be prepared, the Direct Method and the Indirect Method. Accounting standards like the International Accounting Standard No. 7 prefer and recommend the Indirect Method. The main areas presented in this statement are the operating, investing and financing activities. The operating activities show the net cash inflow or outflow derived from the firm's operations.

The investing activities consists of the net cash inflow or outflow obtained from the disposal and/or acquisition of non current assets, while the financing activities are the net cash flow gained from the finance of the business. The resulting figure in the cash flow statement that is particularly emphasized is the increase or decrease in cash and cash equivalent during the year. The reason why this is the last statement prepared is because it requires information from all the other statements. For example, in the operating activities it needs the profit derived for the year, which is obtained from the income statement. The investing and financing activities, on the other hand, analyze the cash equivalents derived or spend from the non current assets, equity and long-term liabilities, which are presented in the balance sheet.

1. 2 Interrelationship between financial reports in financial statementsThe interrelationship of the aforementioned financial reports arises first of all

from the fact that they need to be prepared in an appropriate sequence because they required information from one statement to the other as already mentioned in the previous sub-section. It is also important to note that all the figures from theses financial reports are determined from the operations of the firm. For example, profits are derived from the capability of generating sales revenue and controlling costs, while positive cash flow is also achieved by generating sales revenue and controlling costs, but in addition it requires collection of debts and control on capital expenditure. 1. 3 Utility of financial statementsFinancial statements are very important for external users like lenders, government, shareholders and more, because they shed light on the financial performance, position and cash flow of the firm. Such information will help these users in their economic decisions. For example, a potential investor, before investing in an organization will first examine the financial statements of the firm to determine the risk and expected return from such investment.

1. 4 Final Thought – Need of AccountancyAccountancy is imperative in today's business environment because it enables the process that leads to the generation of financial statements, and thus aids the decision making process of individuals or entities involved. It also reveals the management stewardship, which is important especially in cases where the investors are not managing the firm. 986 WORDSReferences: AccountingInfo.

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