




Financial Statements

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Financial Statements

- Provide information about a company's past, present, & future performance
- Used internally & externally
- Must follow GAAP or IAS or National AS (GAAP) when creating

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- General purpose financial statements (referred to as ‘financial statements’) are those intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.

Qualitative characteristics of financial statements

- Understandability
- Reliability
- Comparability
- Relevance
- True and Fair View/Fair Presentation



Financial statements shall **present fairly the financial position,** financial performance and cash flows of an entity. **Fair presentation requires** the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the *Framework*.

According to IFRS financial statements consist of:

- a statement of financial position as at the end of the period;
- a statement of comprehensive income for the period;
- a statement of changes in equity for the period;
- a statement of cash flows for the period;
- notes, comprising a summary of significant accounting policies and other explanatory information;

Materiality */същественост/*

- Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

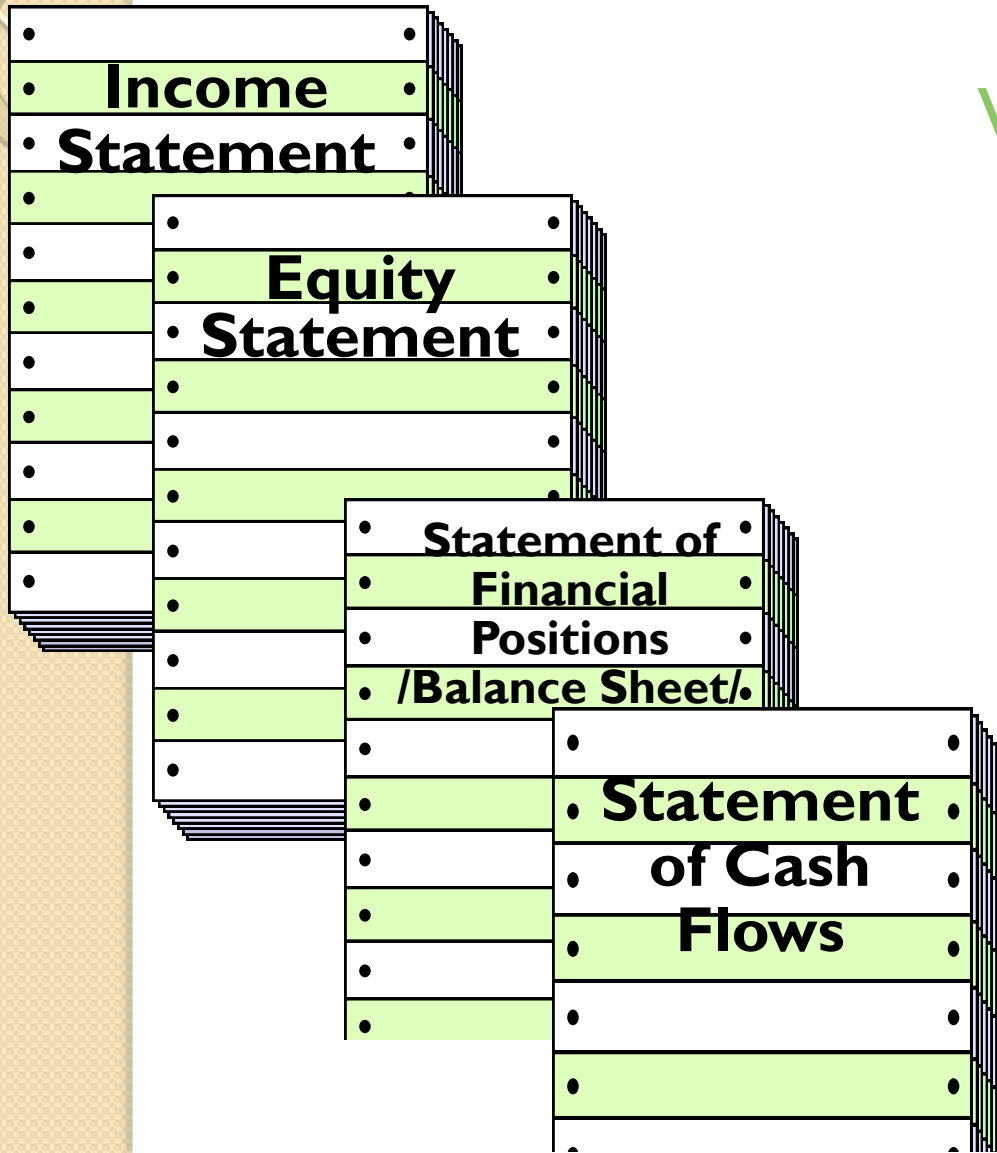
Comparative information

Except when IFRSs permit or require otherwise, an entity shall disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Statement of financial positions

- Mirrors the Accounting Equation
 - Assets = Liabilities + Equity
 - Uses of funds = Sources of funds
- Assets are listed in order of liquidity
 - Current and non-current
- Liabilities are listed in order of maturity
- Equity consists of Contributed Capital and Retained Earnings

The Four Basic Financial Statements



Which two are the most important?



Assets

To be reported on a Statement of Financial Positions, an asset must:

- Be owned or controlled by the company
- Must possess expected future benefits

Most Assets are Reported at Historical Cost

- Historical Cost is
 - Objective
 - Verifiable
 - Therefore, not subject to bias
- However, historical cost is not particularly “relevant” to most readers of the balance sheet
- “Relevance vs. Reliability” is an important issue with accountants.

Liabilities

- **Liabilities are listed in order of maturity**
 - **Current Liabilities come due in less than a year.**
 - **Non-current liabilities come due after a year.**
- **Companies desire more current assets than current liabilities – *this difference is called net working capital***

Equity

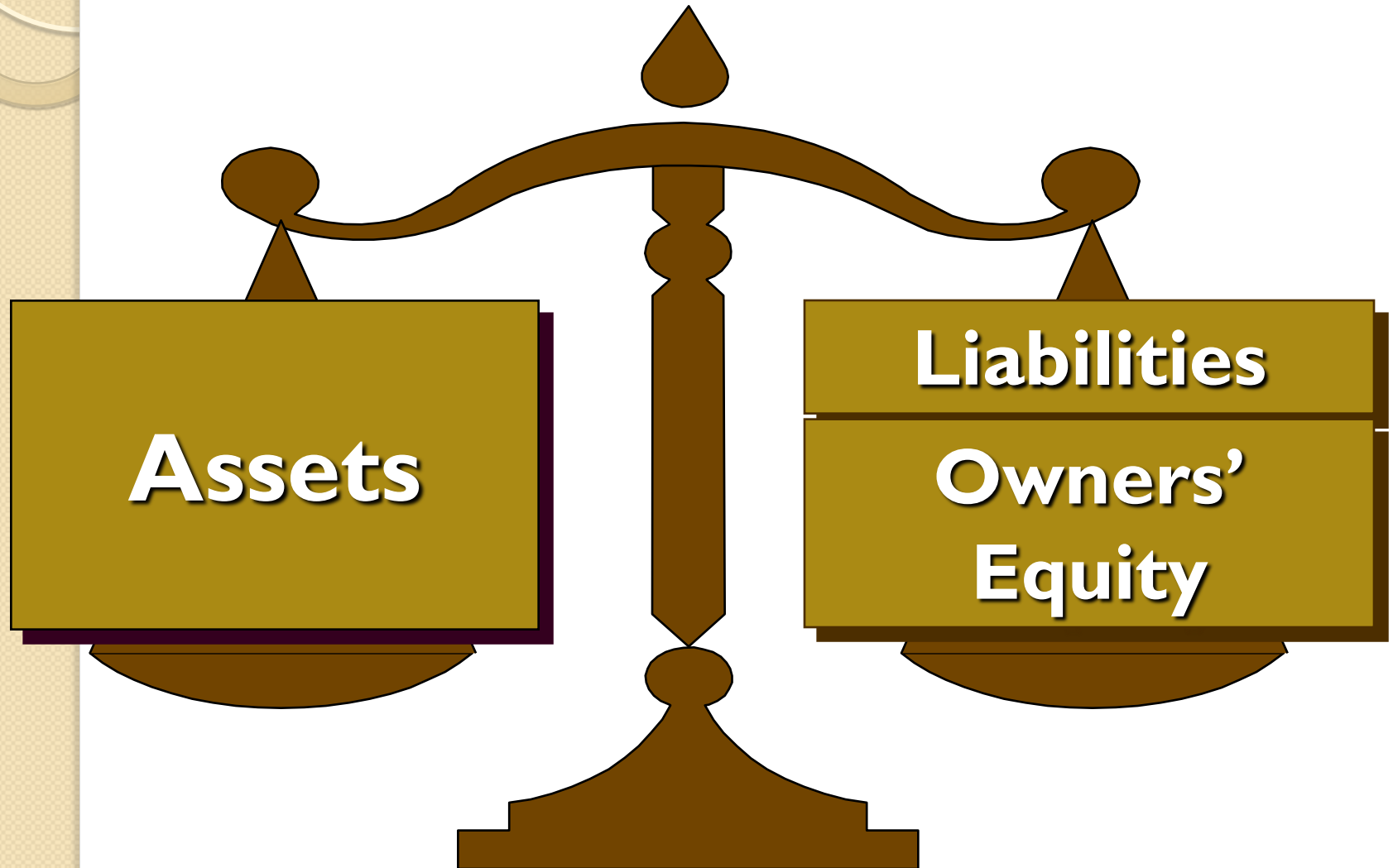
Equity consists of:

- **Contributed Capital (cash raised from the issuance of shares)**

Earned Capital (retained earnings). Retained Earnings is updated each period as follows:

$$\begin{array}{r} \text{Beginning retained earnings} \\ \pm \text{ Net income (loss)} \\ - \text{ Dividends} \\ \hline = \text{Ending retained earnings} \end{array}$$


Statement of financial positions model




Assets = Liabilities + Owners' Equity



**Things of
value
owned by
the
business.**



**Debts owed
by the
business.
(i.e., the
creditors' claims
against the
assets)**



**Owners'
interest in the
business.
(i.e., the owners'
claims against the
assets)**

Components of Owners' /stockholders'/ Equity

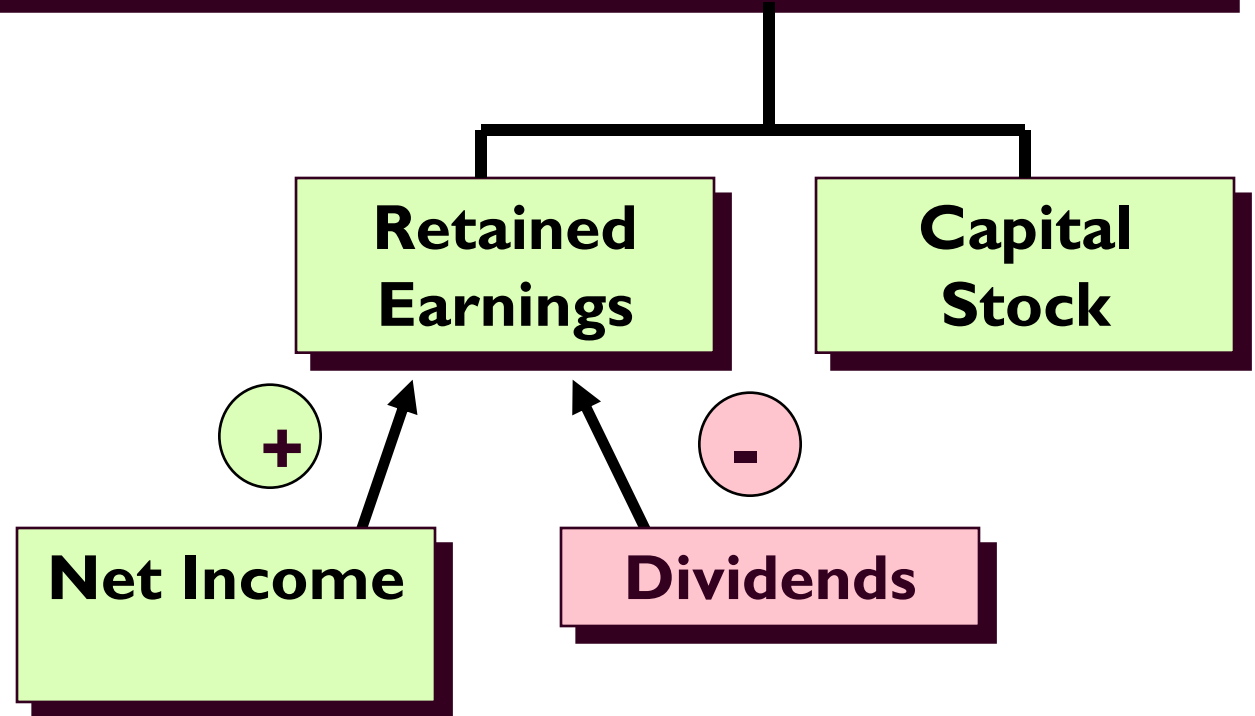
① Capital stock

- Amount the owners have invested in the corporation.

② Retained earnings

- Net income earned since the beginning of the company, less any dividends paid.

Assets = Liabilities + Owners' Equity



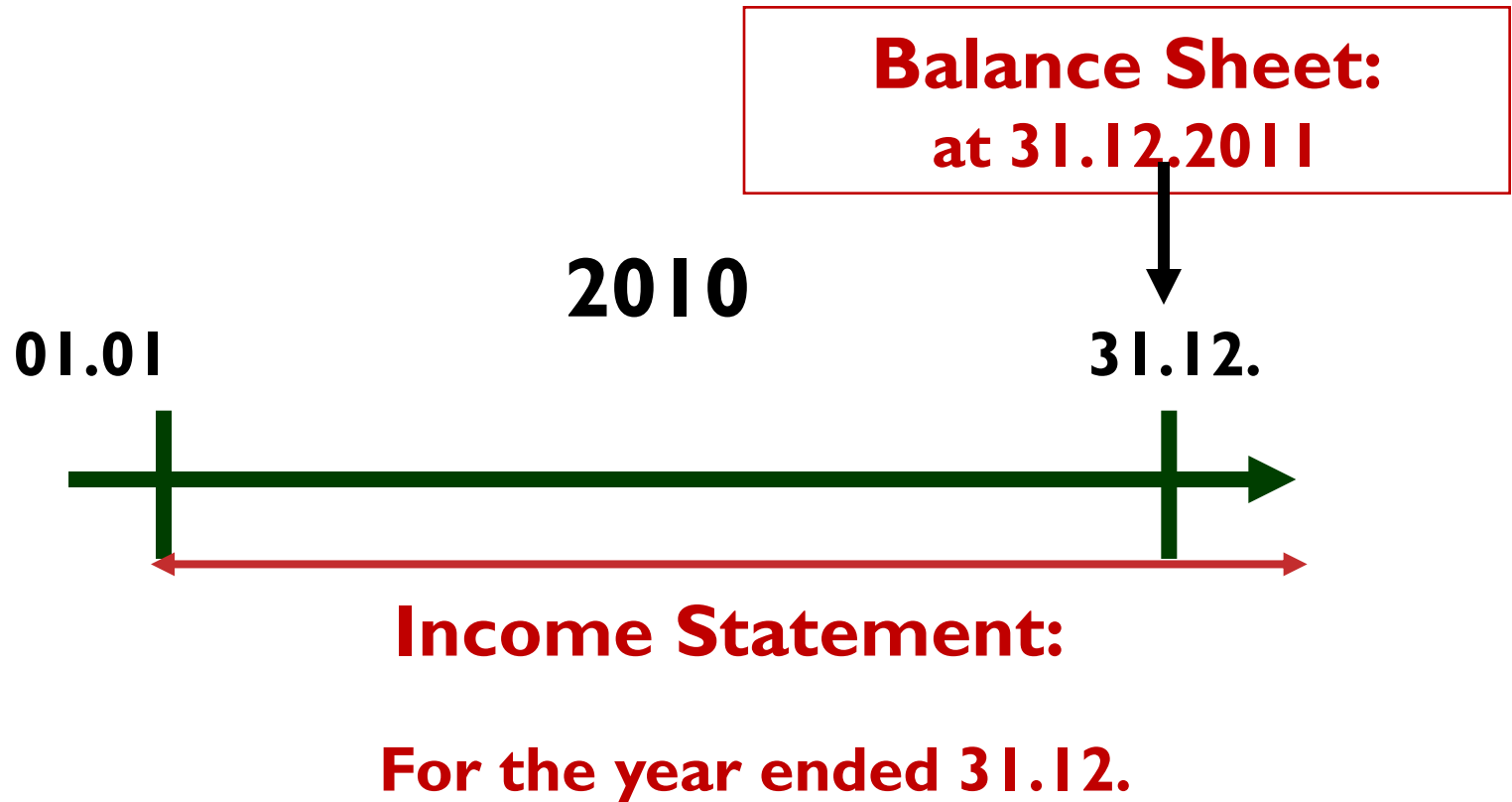
Sources of assets

Assets = Liabilities + Stockholders' Equity

Why was it called a “Balance Sheet”?

Basic algebra

Timing of Statement of Financial Positions and Income Statement



Forms of Statement of Financial Positions

- IN ONE COLUMN
- IN TWO COLUMNS

Model of One column Statement of Financial Positions

ASSETS

- NON-CURRENT
- CURRENT

TOTAL ASSETS

Equity and liabilities

Capital and reserves

LIABILITIES

NON-CURRENT LIABILITIES

CURRENT LIABILITIES

TOTAL EQUITY AND LIABILITIES

TOTAL ASSETS = TOTAL EQUITY AND LIABILITIES

Model of Two column Statement of Financial Positions

Assets		Liabilities		
Non-current assets		Owners' Equity		
Current Assets		Non-current liabilities		
		Current liabilities		
Total Assets		=	Total Equity and Liabilities	

Market Value vs. Book Value

Stockholders' equity = Company book value

- **Book value is determined using IAS/GAAP.**
- **Book value is not the same as Market Value.**
- **Market Value = # of Shares x Price per share**

Statement of comprehensive income

An entity shall present all items of income and expense recognised in a period:

(a) in a single statement of comprehensive income,

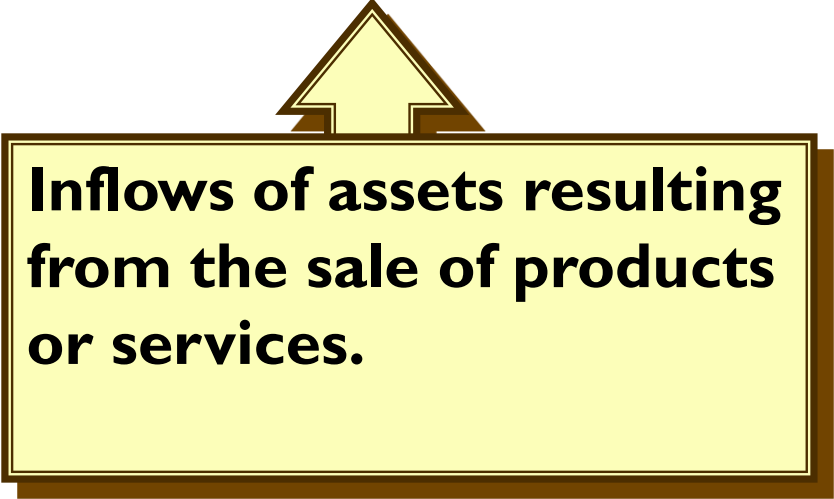
or

(b) in two statements: a statement displaying components of profit or loss (separate income statement) and a second statement beginning with profit or loss and displaying components of other comprehensive income (statement of comprehensive income).

$$\begin{array}{r} \text{Total net sales (revenues)} \\ - \text{Total expenses (costs)} \\ \hline = \text{Net income (loss)} \end{array}$$

Income Statement Model

$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$



Inflows of assets resulting from the sale of products or services.

Income Statement Model

$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$



**Costs incurred to produce revenues or,
Assets used up in the process of earning revenues.**

Income Statement Model

$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$



NET INCOME results when Revenues exceed Expenses for a given period.

Caution!

Must use the correct accounting definitions!

Not yours, not Webster's and not one from Economics class.

Income Statement Model

$$\text{Net Loss} = \text{Revenues} - \text{Expenses}$$



NET LOSS results when
Expenses exceed
Revenues for a given
period.

Statement of Owners' Equity

- **Statement of Equity is a reconciliation of the beginning and ending balances of stockholders' equity accounts.**
- **Main equity categories are:**
 - **Contributed capital**
 - **Retained earnings (including Other Comprehensive Income or OCI)**
 - **Treasury stock**

Statement of Cash Flows

- **Statement of cash flows (SCF) reports cash inflows and outflows**
- **Cash flows are reported based on the three business activities of a company:**
 1. **Operating activities**: transactions related to the operations of the business.
 2. **Investing activities**: acquisitions and divestitures of long-term assets
 3. **Financing activities**: issuances and payments toward equity, borrowings, and long-term liabilities.

Articulation of Financial Statements

- **Financial statements are linked within and across time – they articulate.**
- **Balance sheet and income statement are linked via retained earnings.**
- **Absent of equity transactions such as stock issuances and purchases and dividend payments, the change in stockholders' equity equals the income or loss for the period.**