Financial Statements

Concept of Financial statements

Financial statements are reports prepared by a company's management to present the financial performance and position at a point in time. A general-purpose set of financial statements usually includes a balance sheet, income statements, statement of owner's equity, and statement of cash flows. These statements are prepared to give users outside of the company, like investors and creditors, more information about the company's financial positions. Publicly traded companies are also required to present these statements along with others to regulatory agencies in a timely manner.

The objective of financial statements

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions.

Financial statements should be understandable, relevant, reliable and comparable. Reported assets, liabilities, equity, income and expenses are directly related to an organization's financial position. The objectives of financial reporting are as follows:

- To provide useful information to the users of financial reports. The information should be useful from a number of perspectives, such as whether to provide credit to a customer, whether to lend to a borrower, and whether to invest in a business. The information should be comprehensible to those with a reasonable grounding in business, which means that it should not be laced with jargon or burdened with so much detail that it is impossible to extract the essentials about a business from its financial statements.

- To provide information about the cash flows to which an entity is subjected, including the timing and uncertainty of cash flows. This information is critical for determining the liquidity of a business, which in turn can be used to evaluate whether an organization can continue as a going concern.
- To disclose the obligations and economic resources of an entity. There should be an emphasis on the changes in liabilities and resources, which can be used to predict future cash flows.

Purpose of financial statement

Financial statements are intended to be understandable by readers who have a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently. Financial statements may be used by users for different purposes:

- Owners and managers require financial statements to make important business decisions that affect its continued operations. Financial analysis is then performed on these statements to provide management with a more detailed understanding of the figures. These statements are also used as part of management's annual report to the stockholders.

- Employees also need these reports in making collective bargaining agreements (CBA) with the management.
- Prospective investors make use of financial statements to assess the viability of investing in a business. Financial analyses are often used by investors and are prepared by professionals (financial analysts), thus providing them with the basis for making investment decisions.
- Financial institutions (banks and other lending companies) use them to decide whether to grant a company with fresh working capital or extend debt securities (such as a long-term bank loan or debentures) to finance expansion and other significant expenditures.

Type of financial statement

balance sheet

The balance sheet, sometimes referred to as the statement of financial position, reports the assets, liabilities, and stockholders' equity of a business enterprise at a specific date. This financial statement provides information about the nature and amounts of investments in enterprise resources, obligations to creditors, and the owners' equity in net resources. It therefore helps in predicting the amounts, timing, and uncertainty of future cash flows.