University of Miskolc
Institute of Finance and Accounting
Department of Accountancy

Füredi-Fülöp Judit
assistant professor
stfjudit@uni-miskolc.hu

Financial statements

FUNCTIONS OF ACCOUNTING

- Providing (legal) documents
- Recording and following changes in the entity
- Assist managerial decisions
- Provide information to, and protect the interests of users (stakeholders) on LOCAL and GLOBAL level

3

Regulation on accounting

- Europe
  - by Directives
    - 2013/34/EU on annual accounts and on consolidation
    - 2006/43/EK on statutory audit
  - by IAS-IFRS system
- Hungary
  - by law: Act 2000. C. on Accounting

4

LEGAL REQUIREMENTS IN HUNGARY

- In the case of companies that come under **Act C of 2000 on Accounting**, this law sets forth:
  - the **reporting** and **bookkeeping** obligations
  - the **principles** to be followed when compiling reports and keeping accounting records,
  - the related regulations, as well as the requirements connected to **publishing** and **disclosing reports**, and
  - **audit**.

5

REPORTING OBLIGATION

- Economic entities shall prepare an **annual report:**
  - on their operation,
  - as well as their financial and earnings positions,
  - supported by an accounting system,
  - following the closing of the books pertaining to the financial year.
- The annual report must give a **true and fair view** of the holdings of the economic entity and its contents (assets and liabilities), of its financial standing and profit or loss.
- Further information must be provided in the **notes on the accounts**, if the information prescribed prove to be inadequate to give a true and fair view in the balance sheet and in the profit and loss account.

6

FINANCIAL STATEMENTS

- **Financial reporting** is a process through which companies communicate information to the public.
- **Financial statements** describe the financial results of an organization in a consistent way that allows comparison to historical results of the organization and to the results of other organizations.
- Managers and investors can learn about the financial position and prospects of an organization from its financial statements.

7

THE OBJECTIVE OF GENERAL PURPOSE FINANCIAL STATEMENTS

to **provide information** about
- the financial position,
- financial performance, and
- cash flows of an entity

that is useful to a wide range of users in making economic decisions.

To meet that objective, financial statements provide information about an entity's:
- assets
- liabilities
- equity
- income and expenses, including gains and losses
- contributions by and distributions to owners (in their capacity as owners)
- cash flows.

That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

8

COMPONENTS OF FINANCIAL STATEMENTS

A complete set of financial statements includes:
1. a statement of financial position (**balance sheet**) at the end of the period
2. a statement of profit or loss and other comprehensive income for the period (presented as a single statement, or by presenting the profit or loss section in a separate statement of **profit or loss**, immediately followed by a statement presenting **comprehensive income** beginning with profit or loss)
3. a statement of **changes in equity** for the period
4. a statement of **cash flows** for the period
5. **notes**, comprising a summary of significant accounting policies and other explanatory notes comparative information prescribed by the standard.

- All financial statements are required to be presented with **equal prominence**.
- Reports that are presented outside of the financial statements – including financial reviews by management, environmental reports, and value added statements – are outside the scope of IFRSs.

9

STRUCTURE AND CONTENT OF FINANCIAL STATEMENTS IN GENERAL

IAS 1 requires an entity to clearly **identify**:
- the financial statements, which must be distinguished from other information in a published document
- each financial statement and the notes to the financial statements.

In addition, the following **information** must be displayed prominently, and repeated as necessary:
- the **name** of the reporting entity and any change in the name
- whether the financial statements are a **group of entities** or an **individual** entity
- information about the **reporting period**
- the presentation **currency**
- the **level of rounding** used (e.g. thousands, millions).

10

REPORTING PERIOD

- There is a presumption that financial statements will be prepared at **least annually**.
- If the annual reporting period changes and financial statements are prepared for a different period, the entity must
  - disclose the reason for the change and
  - state that amounts are not entirely comparable.

11

THE BALANCE SHEET

- The **balance sheet** is a snapshot of the financial status of an organization at a point in time
  - also called statement of financial position or
  - statement of financial condition

12

CORPORATE RESOURCES

What is specific to accounting in the view of these resources?

We are interested both

- about the use of the resource in the activity of the entity

ACTIVES or ASSETS

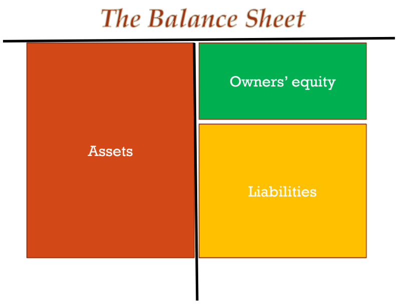
- and about the origin of the resources (also called the source of finance)

PASSIVES or EQUITY & LIABILITIES

13

CORPORATE RESOURCES

- *Balance sheet: A = Eq + L*



14

BALANCE SHEET EQUATION

Assets = Liabilities + Owners' equity

Assets are economic resources that are expected to benefit future activities of the organization.

Liabilities are the entity's economic obligations to nonowners.

Equities are the claims against, or interests in, the assets of the organization.

Owners' equity is the excess of the assets over the liabilities. The owners' equity of a corporation is called stockholders' equity.

15

LINE ITEMS

THE LINE ITEMS TO BE INCLUDED ON THE FACE OF THE STATEMENT OF FINANCIAL POSITION ARE: [IAS 1.54]

(a) property, plant and equipment	(k) trade and other payables
(b) investment property	(l) provisions
(c) intangible assets	(m) financial liabilities (excluding amounts shown under (k) and (l))
(d) financial assets (excluding amounts shown under (e), (h), and (i))	(n) current tax liabilities and current tax assets, as defined in IAS 12
(e) investments accounted for using the equity method	(o) deferred tax liabilities and deferred tax assets, as defined in IAS 12
(f) biological assets	(p) liabilities included in disposal groups
(g) inventories	(q) non-controlling interests, presented within equity
(h) trade and other receivables	(r) issued capital and reserves attributable to owners of the parent.
(i) cash and cash equivalents	
(j) assets held for sale	

16

- Additional line items, headings and subtotals may be needed to fairly present the entity's financial position. [IAS 1.55]

Format of statement

- IAS 1 does not prescribe the format of the statement of financial position.
- Assets can be presented current then non-current, or vice versa, and liabilities and equity can be presented current then non-current then equity, or vice versa.

17

Balance sheet ...

Assets	*Liabilities*
A. INVESTED OR FIXED ASSETS	D. OWNERS'S EQUITY
I. INTANGIBLE ASSETS	I. ISSUED CAPITAL STOCK
II. TANGIBLE ASSETS	~~II. NOT PAID ISSUED CAPITAL STOCK~~
III. FINANCIAL ASSETS	III. CAPITAL RESERVE
	IV. ACCUMULATED PROFIT RESERVE
B. CURRENT ASSETS	V. FIXED RESERVE
I. INVENTORY (STOCKS)	VI. VALUATION RESERVE
II. RECEIVABLES (DEBTORS)	~~VII. RETAINED PROFIT OF THE YEAR (NET PROFIT)~~
III. SECURITIES	~~E. PROVISIONS~~
(short term financial investments)	F. LIABILITIES
IV. CASH AT BANK AND IN HAND	~~I. DEFERRED LIABILITIES~~
	II. LONG-TERM LIABILITIES
~~C. PREPAID EXPENSES (ACCRUED AND DEFERRED ASSETS)~~	III. SHORT-TERM LIABILITIES
	~~G. ACCRUED INCOME~~

Σ Assets = Σ Liabilities

18

ASSETS

- All the things, which are held or used by the undertaking for its operations (not including leased assets), shall be shown in the balance sheet as assets, regardless of whether the undertaking gains ownership of such assets upon the satisfaction of certain conditions prescribed by law or stipulated in the contract. Deferred expenses and accrued income shall also be shown as assets.

On the basis of their purpose and utilization: assets shall be listed among invested assets or current assets

- Those assets shall be classified as **invested assets**, the purpose of which is to serve the undertaking's activities and operations on a long-term basis, for a period of no less than one year.
  - The category of invested assets shall consist of intangible assets, tangible assets and financial investments.
- Inventories, receivables which do not serve the undertaking's interests on a long term basis, securities signifying a creditor relationship, share certificates and liquid assets shall be shown under **current assets**.

19

INVESTED ASSETS – INTANGIBLE ASSETS

- Are a class of long-lived assets that are not physical in nature.
- Assets other than tangible assets (such as concessions and similar rights, intellectual products, goodwill), advances shall be shown under intangible assets:
  - rights which are not related to real property: lease rights, rights of use, rights of utilization of intellectual products, licenses,
  - intellectual products: inventions, patents and industrial design of assets protected under industrial law, copyrighted software products, know-how and production technologies, trademarks, etc.

20

INVESTED ASSETS –TANGIBLE ASSETS

- Material assets
  - land,
  - forest,
  - buildings,
  - other structures,
  - technical equipment,
  - machinery,
  - vehicles,
  - plant and business accessories, other equipment,

  shall be shown under tangible assets which:
    - serve the undertaking's operations,
    - directly or indirectly,
    - on a permanent basis.

21

INVESTED ASSETS – FINANCIAL INVESTMENTS

- Assets (participations, securities, loans,) which
  - have been invested by the undertaking in another undertaking or
  - have been transferred to another undertaking for the purpose
    - of gaining permanent income (dividends or interest) or
    - an influencing, directive or controlling option

    therein shall be shown under financial investments.

22

CURRENT ASSETS - INVENTORIES

Inventories are assets serving the undertaking's activities, directly or indirectly, which

a) were acquired for the **purpose of resale** within the framework of regular (routine) business operations, and which remain unaltered before sold (goods, packings, intermediation), however, their value may change,

b) are **in a specific phase of production** prior to sale [work in progress, and semi-finished products] or which are processed and completed, and are in the process of sale (finished products),

c) are to be used for the production of products to be sold or during the provision of services (raw **materials**).

Inventories shall further **include**:

the tangible assets (tools, instruments, equipment, fittings, work clothing, uniforms, protective clothing) before put into use, and which serve the undertaking's activities for a period of less than one year.

23

CURRENT ASSETS - RECEIVABLES

- Receivables are the payment claims:
  - expressed in money,
  - arising lawfully from various supply, work, service and other contracts
  - which are related to
    - the supply of products and services,
    - the sale of securities signifying a creditor relationship and share certificates,
    - extension of loans,
    - advance payments,
    - including various other receivables,
  - which have already been performed by the company
  - and have been accepted and acknowledged by the other party,
  - and also claims awarded by final court decisions.

24

CURRENT ASSETS - SECURITIES

- Securities purchased for investment purposes, as temporary, non-permanent investments,
- securities signifying a creditor relationship
- and investments in share certificates

shall be shown as securities under current assets.

25

CURRENT ASSETS - -LIQUID ASSETS

- Liquid assets include cash, electronic moneys and checks,
- and bank deposits.

26

OWNER'S EQUITY AND LIABILITIES

- In the balance sheet the undertaking's own funds, reserves, liabilities, and accrued expenses and deferred income shall be shown under owner's equity and liabilities.

27

OWN FUNDS / OWNER'S EQUITY

- That part of the capital :
  - which has been supplied/invested by the owner (shareholder) for the undertaking (Contributed Capital) ,
  - or which has been left by the owner (shareholder) with the undertaking (were not distributed to the owners) from the after-tax profit (Retained Earnings) . These can accumulate to a large sum over the years.
- Owner's Equity is by **definition** the difference between the Assets of a company and its Liabilities.

28

LIABILITIES

- Are the acknowledged debts to be performed in money and arising from supply, work, service and other contracts
- which are related to supplies, services and the provision of money
- already performed by the supplier, company, service provider, creditor or the party extending a loan,
- and accepted and acknowledged by the company.

There are long-term and short-term liabilities.

29

LONG TERM LIABILITIES

Long-term liabilities are, based on the contract concluded with the creditor, loans and credits received for a term of more than one year (including the issue of bonds), less repayments due within one year of the balance sheet date, including other long-term liabilities.

30

SHORT-TERM/ CURRENT LIABILITIES

- Short-term liabilities are loans and credits received for a term of one financial year or less,
  - including, from long-term liabilities, installments repayable within one financial year from the balance sheet date.

  Short-term liabilities, in general, include:
  - advance payments received from customers,
  - obligations from the purchase of goods and services from suppliers,
  - bills payable,
  - dividends,
  - profit-sharing and the yields on interest-bearing securities,
  - and other short-term liabilities.

31

CHANGES IN CORPORATE RESOURCES

- We set up companies to earn money
  - → companies must obtain profit
- How can companies make profit?
  - by producing and selling goods
  - by providing services
  - → continuously changing its resources
- This means that: $\Delta A = \Delta Eq + \Delta L$

32

- We record the changes in the bookkeeping
- Also called double entry bookkeeping
- Why?
  - Because when a change occurs in the resources of the entity, since we view the resources in a double manner (as actives and passives), the change always appears as a “double change” or “double entry”
  - Please notice that we must have:

$$\Delta A = \Delta Eq + \Delta L$$

33

EXAMPLE 1

- We purchase commodities for 1.000 € and we pay the equivalent in cash.
  - We have an increase in Current assets / Inventories / Commodities
  - We have a decrease in Current assets / Cash / Cash in hand)

34

BALANCE SHEET 1

Assets	Owners' equity / Liabilities
A. Non-current assets I. Intangible assets II. Tangible assets III. Financial assets B. Current assets I. Inventories a. Commodities +1.000€ II. Receivables III. Securities IV. Cash a. Cash at hand -1.000€	**Owners' equity** A. Owners' equity I. Share capital II. Share premiums III. Reserves/retained earnings **Liabilities** B. Long term liabilities I. Long term bank loans II. Debentures C. Short term liabilities I. Trade payables II. Salaries III. Taxes

35

EXAMPLE 2

- We purchase commodities for 1.000 € and we do not pay the equivalent (we purchase on credit).
  - We have an increase in Current assets / Inventories / Commodities
  - We have an increase in Liabilities / Short term liabilities / Trade payables

36

BALANCE SHEET 2

Assets

A. Non-current assets
   I. Intangible assets
   II. Tangible assets
   III. Financial assets
B. Current assets
   I. Inventories
      a. Commodities +1.000€
   II. Receivables
   III. Securities
   IV. Cash

Owners' equity

A. Owners' equity
   I. Share capital
   II. Share premiums
   III. Reserves/retained earnings

Liabilities

B. Long term liabilities
   I. Long term bank loans
   II. Debentures
C. Short term liabilities
   I. Trade payables +1.000€
   II. Salaries
   III. Taxes

37

EXAMPLE 3

- Our owners contribute to the capital of the entity commodities of 1.000 €.
  - We have an increase in Current assets / Inventories / Commodities
  - We have an increase in Owners' equity/ Share capital

38

BALANCE SHEET 3

Assets

A. Non-current assets
   I. Intangible assets
   II. Tangible assets
   III. Financial assets
B. Current assets
   I. Inventories
      a. Commodities +1.000€
   II. Receivables
   III. Securities
   IV. Cash

Owners' equity

A. Owners' equity
   I. Share capital +1.000€
   II. Share premiums
   III. Reserves/retained earnings

Liabilities

B. Long term liabilities
   I. Long term bank loans
   II. Debentures
C. Short term liabilities
   I. Trade payables
   II. Salaries
   III. Taxes

39

The Firm's Operating Cycle and Its Impact on the Firm's Balance Sheet

40

INCOME STATEMENT

- The **income statement** measures the performance of an organization by matching
  - its accomplishments (revenue from customers, which is usually called sales) and
  - its efforts (cost of goods sold and other expenses).

41

CHANGES IN CORPORATE RESOURCES

- During the changes
  - Companies consume their resources (we have a decrease in the value of the resources)
    - We call them: **Expenses** (E)
  - Companies create new resources (we have an increase in the value of the resources)
    - We call them: **Income** (I)

Results (Net income, Profit) = Income – Expenses

NI = I - E

42

INCOMES/ REVENUES AND EXPENSES

- **Incomes /Revenues** are increases in ownership
  - claims arising from the delivery of goods or services.
  - Revenues must be earned
  - Revenues must be realized
- **Expenses** are decreases in ownership
  - claims arising from delivering goods or services or using up assets.

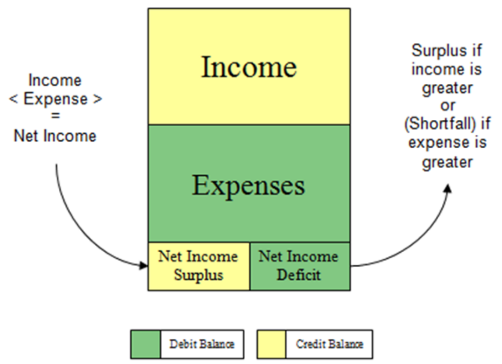
43

ACCRUAL BASIS AND THE CASH BASIS OF ACCOUNTING

accrual basis	cash basis
recognize revenue and expense	
when they occur	when cash is received and disbursed

44

STATEMENT OF FINANCIAL ACTIVITIES - DIAGRAM



45

INCOME STATEMENT

Expenses	Income
A. Operating expenses I. Cost of raw materials and energy consumed II. Cost of goods sold III. Wages & social contributions IV. Depreciation & impairment V. Others (taxes, charges) B. Financial expenses I. Interests paid II. Impairment of financial assets	A. Operating income I. Sales (turnover) II. Change in internally generated inventories III. Capitalized value of assets B. Financial income I. Dividends received II. Income from sale of shares III. Interests received
Net income (profit or loss for the financial year)	

46

STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME

Concepts of profit or loss and comprehensive income

- **Profit or loss** is defined as
  - the total of income less expenses, excluding the components of other comprehensive income".
- **Other comprehensive income** is defined as
  - comprising "items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs".
- **Total comprehensive income** is defined as
  - "the change in equity during a period resulting from transactions and other events, other than those changes resulting from transactions with owners in their capacity as owners".

Comprehensive income for the period	=	Profit or loss	+	Other comprehensive income

47

PROFIT OR LOSS SECTION OF STATEMENT

Minimum line items must be presented in the profit or loss section:

- revenue
- gains and losses from the derecognition of financial assets measured at amortised cost
- finance costs
- share of the profit or loss of associates and joint ventures accounted for using the equity method
- certain gains or losses associated with the reclassification of financial assets
- tax expense
- a single amount for the total of discontinued items

Expenses recognised in profit or loss should be analysed either by nature (raw materials, staffing costs, depreciation, etc.) or by function (cost of sales, selling, administrative, etc).

Items cannot be presented as 'extraordinary items' in the financial statements or in the notes.

48

OTHER COMPREHENSIVE INCOME SECTION

The other comprehensive income section is required to present line items which are classified by their nature, and grouped between those items that will or will not be reclassified to profit and loss in subsequent periods.

49

The balance sheet equation can highlight the link between the income statement and balance sheet.

ASSETS = LIABILITIES + EQUITY

RETAINED EARNINGS + SHARE CAPITAL = EQUITY

RETAINED EARNINGS = OPENING RETAINED EARNINGS + NET INCOME - DIVIDENDS

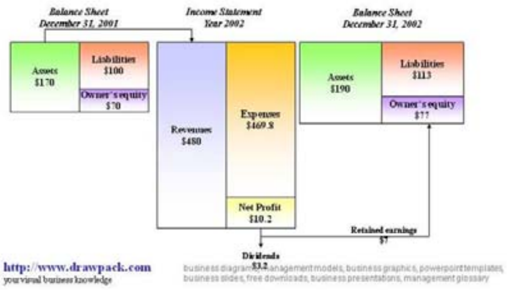
REVENUES – EXPENSES = NET INCOME

•Dividends are a distribution of the after-tax profits of a business to the shareholders (owners)

•Dividends reduce the equity in the business

50

The Link Between the Balance Sheets and the Income Statement



51

EXAMPLE 4

- We sell commodities for 1.000€ in cash.
- The value of these commodities sold on purchase price is 650€.
  - We have an increase in cash of 1.000€.
  - We have an increase in Income of 1.000€.
  - We have a decrease in the inventory of commodities of 650€.
  - We have an increase in expenses of 650€.

52

BALANCE SHEET 4

Assets	Owners' equity / Liabilities
A. Non-current assets I. Intangible assets II. Tangible assets III. Financial assets B. Current assets I. Inventories a. Commodities -650€ II. Receivables III. Securities	**Owners' equity** A. Owners' equity I. Share capital II. Share premiums III. Reserves IV. Retained earnings (Net income) +1.000€-650€ **Liabilities** B. Long term liabilities I. Long term bank loans II. Debentures C. Short term liabilities I. Trade payables II. Salaries III. Taxes

53

INCOME STATEMENT 4

Expenses	Income
A. Operating expenses I. Cost of raw materials and energy consumed II. Cost of goods sold +650€ III. Wages & social contributions IV. Depreciation & impairment V. Others (taxes, charges) B. Financial expenses I. Interests paid II. Impairment of financial assets	A. Operating income I. Sales (turnover) +1.000€ II. Change in internally generated inventories III. Capitalized value of assets B. Financial income I. Dividends received II. Income from sale of shares III. Interests received
Net income (profit or loss for the financial year) +350€ (profit)	

54

STATEMENT OF CASH FLOWS

- IAS 7 *Statement of Cash Flows*.
- The objective: the presentation of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows, which classifies cash flows during the period according to
  1. operating,
  2. investing, and
  3. financing activities.
- The statement of cash flows analyses changes in cash and cash equivalents during a period.
- Cash and cash equivalents comprise
  - cash on hand and
  - demand deposits, together with
  - short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value.

55

STATEMENT OF CHANGES IN EQUITY

The statement must show:

- total comprehensive income for the period, showing separately amounts attributable
  - to owners of the parent and
  - to non-controlling interests
- the effects of any retrospective application of accounting policies or restatements made, separately for each component of other comprehensive income
- reconciliations between the carrying amounts at the beginning and the end of the period for each component of equity, separately disclosing:
  - profit or loss
  - other comprehensive income
  - transactions with owners, showing separately
    - contributions by and
    - distributions to owners and
    - changes in ownership interests in subsidiaries that do not result in a loss of control.

56

Example: Statement of Changes in Equity
(with changes in accounting policy)

	Share Capital ($000)	*Retained earnings ($000)*	*Cash flow hedges ($000)*	*Re-valuation surplus ($000)*	*Total ($000)*
Balance at 1/01/2011	xxx	xxx	xxx	–	xxx
Changes in accounting policy	–	xxx	–	–	xxx
Restated balance	xxx	xxx	xxx	–	xxx
Changes in equity for 2011					
Dividends	–	(xxx)	–	–	(xxx)
Total comprehensive Income for the year	–	xxx	(xxx)	xxx	xxx
Balance at 31 December 2011	xxx	xxx	(xxx)	xxx	xxx
Changes in equity for 2012					
Issue of share capital	xxx	–	–	–	xxx
Dividends	–	(xxx)	–	–	(xxx)
Total comprehensive income for the year	–	xxx	(xxx)	xxx	xxx
Transfer to retained earnings	–	xxx	–	(xxx)	–
Balance at 31 December 2012	xxx	xxx	(xxx)	xxx	xxx

NOTES TO THE FINANCIAL STATEMENTS

The notes must:

- present information about the basis of preparation of the financial statements and the specific accounting policies used
- disclose any information required by IFRSs that is not presented elsewhere in the financial statements and
- provide additional information that is not presented elsewhere in the financial statements but is relevant to an understanding of any of them

Notes are presented in a systematic manner and cross-referenced from the face of the financial statements to the relevant note.

58

NOTES TO THE FINANCIAL STATEMENTS

IAS 1. suggests that the notes should normally be presented in the following order:

- a statement of compliance with IFRSs
- a summary of significant accounting policies applied, including:
  - the measurement basis (or bases) used in preparing the financial statements
  - the other accounting policies used that are relevant to an understanding of the financial statements
- supporting information for items presented on the face of the statement of financial position (balance sheet), statement(s) of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows, in the order in which each statement and each line item is presented
- other disclosures, including:
  - contingent liabilities and unrecognised contractual commitments
  - non-financial disclosures, such as the entity's financial risk management objectives and policies.

59

THANK YOU FOR YOUR ATTENTION!

60