Unit 6: Basic Financial Statements 18 LHs

- Financial statements: concept, objectives and limitations;
- Basic Nepal Accounting Standards (NASs): NAS 1: Presentation of financial statements, NAS 2: Inventories, NAS 7: Statement of cash flow, NAS 8: Accounting policies, changes in accounting estimates and errors, NAS 10: Events after reporting period, NAS 16: Property, plant and equipment
- Preparation of financial statement under NFRS:
- Statement of Profit or Loss (Income Statement): concept, types and components of profit or loss statement ,
- Statement of financial position (Balances Sheet): concept, purpose, components and preparation of classified statement of financial position or balance sheet;

- Statement of other comprehensive income: concept,
- components and preparation of other comprehensive income statement;
- Statement of changes in equity: concept, components and preparation of statement of changes in equity.
- Cash Flow Statement: Meaning, objectives and limitations of cash flow statement;
- Contents of cash flow statement;
- Preparation and interpretation of cash flow statement using balance-sheets of single and two periods under direct and indirect method.

Concept of Financial statements:

A financial statement is a formal document that provides information about the financial activities and performance of a company or organization. It is prepared by summarizing and organizing financial data in a structured manner, allowing stakeholders to assess the financial health and viability of the entity.

The main purpose of financial statements is to communicate important financial information to various users, such as investors, creditors, regulators, and internal management. These statements help stakeholders make informed decisions, evaluate the company's profitability, solvency, and liquidity, and assess its ability to generate future cash flows.

Financial statements provide the net income or loss of a company for a period of time and to assess the financial position and cash flow situation on a particular date. Financial statements report the result of past activities. Therefore, they are also called as the historical record of a company.

Financial statements provide a picture of the performance, financial position and cash flows of a business. These documents are used by the investment community, lenders creditors and management to evaluate an entity. There are four main types of financial statements, which are as follows:

1. Statement of P/L Account and other Comprehensive income (Income statement)
2. Statement of Change in Financial Position (Balance sheet)
3. Statement of cash flows
4. Statement of changes in equity

Objectives of Financial statements:

The primary objectives of financial statements are to provide useful information about the financial performance and position of a business to various stakeholders, such as investors, creditors, employees, and regulators. **The key objectives of financial statements are as follows**:

1.Provide information about financial performance: Financial statements, such as the income statement or statement of comprehensive income, provide information about a company's revenues, expenses, gains, and losses during a specific period. These statements help stakeholders assess the profitability and operating performance of the business.

2.Communicate financial position: Balance sheets or statements of financial position present the assets, liabilities, and equity of a company at a given point in time. These statements enable stakeholders to understand the company's financial position, including its liquidity, solvency, and overall financial health.

3.Assist in decision-making: Financial statements are important tools for decision-making by investors, creditors, and management. Stakeholders use financial information to evaluate the company's performance, assess its risks and returns, and make informed decisions regarding investments, lending, and business operations.

4. Facilitate comparability and analysis: Financial statements allow for the comparison of financial information across different periods or between different companies. This comparability helps stakeholders analyze trends, identify patterns, and evaluate the company's performance relative to its competitors or industry benchmarks.

5. **Meet regulatory requirements:** Financial statements must comply with generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS) to ensure consistency, transparency, and reliability of financial reporting. These standards help to establish uniformity in financial statements, making them more reliable and comparable.

6. **Provide information for taxation and compliance:** Financial statements serve as a basis for calculating taxable income and determining tax liabilities. They also help businesses comply with legal and regulatory requirements related to financial reporting, such as providing accurate and timely information to regulatory authorities and shareholders.

7.Enhance accountability and transparency: Financial statements promote accountability and transparency by providing a clear and comprehensive view of a company's financial activities. They enable stakeholders to assess how well the company has managed its resources, fulfilled its obligations, and generated returns for its investors.

Limitations of Financial statements:

Financial statements have certain limitations that can impact their usefulness and accuracy. Here are some common limitations of financial statements:

1. **Historical Cost Basis:** Financial statements are typically prepared based on the historical cost principle, which means that assets and liabilities are recorded at their original purchase cost. This may not reflect their current fair market value, especially for assets that have significantly appreciated or depreciated over time.

2. **Omission of Non-Monetary Information:** Financial statements primarily focus on monetary transactions and may not include non-monetary information that can be relevant to decision-making. Factors such as customer satisfaction, employee morale, and market reputation are crucial but not captured in financial statements.

3. **Use of Estimates and Assumptions:** Financial statements often require management to make estimates and assumptions regarding uncertain events, such as the useful life of assets or the collectability of receivables. These estimates can introduce a level of subjectivity and may not always accurately reflect the future outcomes.

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4. **Impact of External Factors:** Financial statements may not fully reflect the impact of external factors, such as changes in economic conditions, new regulations, or shifts in consumer behavior. These factors can significantly influence a company's performance but may not be adequately captured in the financial statements.

5. **Non-Disclosure of Intangible Assets:** Financial statements typically do not include detailed information about intangible assets, such as brand value, patents, copyrights, or intellectual property. These assets can be significant contributors to a company's overall value and may not be fully reflected on the balance sheet.

6. **Different Accounting Policies and Standards:** Companies may adopt different accounting policies and standards, even within the same industry or jurisdiction. This can make it challenging to compare financial statements between companies or over different periods accurately.

7. **Limited Focus on Future Performance:** Financial statements primarily provide information about past performance and may not explicitly address a company's future prospects. They do not account for potential changes in the competitive landscape, emerging technologies, or shifts in consumer preferences.

Basic Nepal Accounting Standards (NASs):

NAS 1: Presentation of financial statements:

Presentation of financial statements. For detailed guidance and application of minimum requirements for their content and format, it is recommended to refer to the official NASs issued by the Nepal Accounting Standards Board (NASB) and consult with accounting professionals familiar with the specific requirements.

Under the Nepal Accounting Standards (NASs), the types of financial statements prepared by entities include:

1. **Profit and loss statement (Income Statement):**
2. **Statement other Comprehensive Income:**
3. **Statement of Financial Position (Balance Sheet):**
4. **Statement of Changes in Equity:**
5. **Statement of Cash Flows:**
6. **Notes to the Financial Statements:** (provide additional information and disclosures related to the financial position, performance, and cash flows of the entity)

NAS 2: Inventories

The NAS 2 provides guidance on the measurement and recognition of inventories, as well as the determination of their cost, subsequent recognition as an expense, and any write-downs or impairments that may be necessary.

NAS 7: Statement of cash flow

The statement of cash flows, also known as the cash flow statement, is a financial statement that provides information about the cash inflows and outflows of an organization during a specific period. The statement of cash flows typically categorizes cash flows into three main activities: i.e. Operating ,Investing and Financing activities.

NAS 8: Accounting policies, changes in accounting estimates and errors:

NAS 8: provides guidelines on selecting and applying accounting policies, making changes in accounting estimates, and correcting errors in financial statements.

NAS 8 outlines the following key points:

1. Accounting Policies
2. Changes in Accounting Policies
3. Changes in Accounting Estimates
4. Correction of Errors

It's important to note that the specific requirements and guidelines may vary depending on the jurisdiction and the applicable accounting framework. Therefore, it is always advisable to refer to the relevant accounting standards applicable in your specific context, such as the Nepal Accounting Standards Board (NASB) or Nepal Financial Reporting Standards (NFRS) if applicable in Nepal.

NAS 10: Events after reporting period,

Events after the reporting period refer to significant events or transactions that occur between the end of a company's reporting period and the date the financial statements are authorized for issue. These events can have a material impact on the financial position and performance of the company, and they require disclosure and evaluation in the financial statements. Here are a few examples of events that may occur after the reporting period:

- Acquisition or sale of a significant business
- Disasters or natural calamities
- Legal settlements
- Changes in accounting estimates:
- Changes in tax regulations or rates
- Issuance or repayment of significant debt or equity

▪ NAS 16: Property, plant and equipment

NAS 16 provides guidance on the recognition, measurement, presentation, and disclosure of property, plant, and equipment (PPE) in Nepal. Here are the key aspects covered by NAS 16:

- **Recognition and Initial Measurement**
- **Measurement after Recognition:**
- **Depreciation:**
- **Revaluation:**
- **Disposal:**

Nepal Accounting Standards issued by the Nepal Financial Reporting Standards Council (NFRSC) for the most accurate and up-to-date information on NAS 16: Property, Plant, and Equipment in Nepal.

Preparation of Financial statement as per NFRS:

Under the Nepal Accounting Standards (NASs), the types of financial statements prepared by entities include:

1. **Profit and loss statement (Income Statement):**
2. **Statement other Comprehensive Income:**
3. **Statement of Changes in Equity:**
4. **Statement of Financial Position (Balance Sheet):**
5. **Statement of Cash Flows:**
6. **Notes to the Financial Statements:**

Profit and loss statement (Income Statement): As per NFRS Profit and loss statement are prepared under two alternatives methods.

i. On the basis of function of expenses

ii. On The basis of Nature of expenses

Profit or Loss Statement
(On the basis of Function of Expense)
For the year ended ....Ashad 20XX (....... July 20XX) *Figures in NPR(000)*

Particulars	Notes	20X2	20X1
Revenue from operations		xxx	xxx
Cost of Sales		xxx	xxx
Gross Profit		**xxx**	**xxx**
Other Income		Xxx	Xxx
Distribution Expenses		(xxx)	(xxx)
Administrative Expenses		(xxx)	(xxx)
Other Operating Expenses		(xxx)	(xxx)
Profit From Operations		**xxx**	**xxx**
Finance Costs		(xxx)	(xxx)
Profit Before Tax		**Xxx**	**xxx**
Income Tax Expense		(xxx)	(xxx)
Profit from Continuing Operations		**xxx**	**xxx**
Profit /(Loss) on Discontinued Operations (Net of tax)		Xxx	xxx
Net Profit for the year		**xxx**	**xxx**
Basic Earnings per share (NPR)		xxx	xxx
Diluted Earnings per share (NPR)		Xxx	xxx
Net Profit attributable to:			
Owners of the Company		xxx	xxx
Non-controlling Interests		Xxx	xxx

Profit or Loss Statement
(On the basis of Nature of Expense)
For the year ended ....Ashad 20XX (....... July 20XX)

Figures in NPR'000

Particulars	**Notes**	**20X2**	**20X1**
Revenue from Operations		Xxx	xxx
Other Income		Xxx	xxx
Changes in Inventories of finished goods and W-I-P		Xxx	xxx
Raw materials and consumables used		(xxx)	(xxx)
Staff Costs/Expenses		(xxx)	(xxx)
Depreciation and amortization expense		(xxx)	(xxx)
Distribution Expenses		(xxx)	(xxx)
Administrative Expenses		(xxx)	(xxx)
Other Operating Expenses		(xxx)	(xxx)
Profit From Operations		Xxx	xxx
Finance Costs		(xxx)	(xxx)
Profit Before Tax		Xxx	xxx
Income Tax Expense		xxx	xxx
Profit from Continuing Operations		Xxx	Xxx
Profit /(Loss) on Discontinued Operations (Net of tax)		Xxx	xxx
Net Profit for the year		xxx	xxx
Basic Earnings per share (NPR)		Xxx	xxx
Diluted Earnings per share (NPR)		xxx	xxx
Net Profit attributable to:			
Owners of the Company		xxx	xxx
Non-controlling Interests		xxx	xxx

Component of Profit and loss statement:

i. Revenue from operation:
ii. Cost of sales =O/S + Purchase +Carriage inward +custom duty – C/S.
iii. Other income
iv. Distributions expenses
v. Administrative expenses
vi. Other operating expenses
vii. Finance cost
viii. Income tax expenses
ix. Profit from continuing operation
x. Profit or loss discontinuing operations

i**. Revenue from operation**:

Revenue from operations refers to the income generated by a company from its core business activities, excluding any non-operational sources such as interest income, dividends, or asset sales. It includes sales of goods and services revenue after discounts, returns, and allowances. It's a key component of a company's P/L statement and is used to assess its performance, efficiency, and profitability.

ii. **Cost of sales:**

The **cost of sales**, also known as the **cost of goods sold (COGS)**, represents the direct costs associated with the production of goods or services that a company sells. These costs include the expenses directly tied to the production of goods and services, such as raw materials, labor, and manufacturing overhead.

i.e. Cost of sales =O/S + Purchase + wages+ Carriage inward +custom duty+ direct exp. – C/S.

iii. **Other income**:

Other income refers to the revenue that a company earns from activities that are not part of its core business operations i.e. interest received ,dividend received, commission received, gain on sale of assets, sundries income etc.

iv**. Distributions expenses**:

Distribution expenses refers the costs incurred by a company in the process of selling and delivering its products or services to customers. They include both direct and indirect costs associated with the marketing, selling, and distribution of goods. i.e. Sales Commissions and Salaries, Advertising and Promotion, Marketing Expenses, Logistics Costs, Warehousing Costs, Depreciation of Sales and Distribution Assets, Packaging and Handling, Training and Development of sales staff etc.

v. Administrative expenses:

Administrative expenses refer to the costs incurred in managing and running the general administrative functions of a business. These expenses are necessary for the overall operation and support of the company but are not directly tied to the production of goods or services. i.e.Depreciation on buildings and office furniture ,Amortization of trademark and other intangibles, Salaries and wages of office staffs, Insurance expenses, Supplies expenses ,Office rent, Printing and stationary ,Depreciation on store furniture and fixtures,Other office related expenses

ii. Statement of other comprehensive income

. . . Company

Statement of Other Comprehensive Income for the year ended . . .

Particulars	Notes	20X2	20X1
Other Comprehensive Income:		**xxx**	**Xxx**
(Items that will be reclassified to profit or loss)			
Loss or Revaluation		xxx	Xxx
Available-for-sale Investment		xxx	Xxx
Cash flow/hedges		xxx	Xxx
Exchange Gain/Loss arising on translation of foreign operation		xxx	Xxx
Share Associates' other comprehensive income		xxx	Xxx
Tax relating to components of other comprehensive income		xxx	Xxx
Total other Comprehensive income (OCI)		**xxx**	**Xxx**