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Financial Statements

1. Meaning of Financial Statements :

Financial statements are the basic and formal annual reports through which the corporate management communicates financial information to its owners and various other external parties which include investors, tax authorities, government, employees,etc. These refer to: the balance sheet (position statement) as at the end of accounting period, the statement of profit and loss of a company and the cash flow statement.

2. Objectives of Financial Statements:

a. To provide information about economic resources and obligations of a business: They are prepared to provide adequate, reliable and periodical information about economic resources and obligations of a business firm to investors and other external parties who have limited authority, ability or resources to obtain information.

b. To provide information about the earning capacity of the business: They are to provide useful financial information which can gainfully be utilised to predict, compare and evaluate the business firm's earning capacity.

c. To provide information about cash flows: They are to provide information useful to investors and creditors for predicting, comparing and evaluating, potential cash flows in terms of amount, timing and related uncertainties.

e. To judge effectiveness of management: They supply information useful for judging management's ability to utilise the resources of a business effectively.

f. Information about activities of business affecting the society: They have to report the activities of the business organisation affecting the society, which can be determined and described or measured and which are important in its social environment.

3. Types of Financial Statements:

The financial statements generally include two statements: balance sheet and statement of profit and loss which are required for external reporting and also for internal needs of the management like planning, decision-making and control. Apart from these, there is also a need to know about movements of funds and changes in the financial position of the company. For this purpose, a cash flow statement is prepard.

4. Uses and Importance of Financial Statements:

The users of financial statements include management, investors, shareholders,creditors, government, bankers, employees and public at large.

a. stewardship Reporting : They provide insight into management's performance, helping shareholders evaluate how well management meets ownership expectations.

b. Policy Foundation : Financial statements in form government fiscal policies, including taxation, and support the development of industrial and economic policies.

c. Credit Assessment: Lenders evaluate financial statements to decide on granting credit to businesses.

d. Investor Guidance: Investors use financial statements to assess a company's profitability, security, and liquidity, aiding in both short and long term investment decisions.

e. Investment Evaluation: Shareholders rely on financial statements to assess the value and stability of their investments, helping them decide on holding or selling.

5. Limitations of Financial Statements:

Though utmost care is taken in the preparation of the financial statements and provide detailed information to the users, they suffer from the following limitations:

a. Lack of Current Valuation: Prepared based on historical cost, they may not reflect the current market values due to changes in money's purchasing power.

b. Potential Bias: Financial statements may reflect subjective judgments, making results less objective.

c. Limited Detail: They provide aggregate information, which may not be sufficient for all decision-making needs.

d. Omission of Vital Factors: Important information like market loss or contract cessations isn't disclosed.

e. No Qualitative Insight: They lack non-monetary information on factors like labor relations and quality of work.

f. Interim View: Profit/loss and balance sheet data are limited to a specific period, not showing long-term capacity or future changes.