منشآت
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الهيئة العامة للمنشآت الصغيرة والمتوسطة
Small & Medium Enterprises General Authority

Financial Statements

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The Concept of Financial Statements

Financial statements are an essential element to clarify the financial position of companies and organizations. They are a set of financial data for a company, and often contain information on profits and losses, balance sheet and cash flows. These statements are considered activities applied by all companies, by relying on the use of accounting principles.

Who Requires Financial Statements?

- **Executive Management:**

Those responsible for decision-making, crafting financial budgets, and devising business strategies. Additionally, company owners and stakeholders seek insight into management's actions and performance over the course of the year. While one might evade numbers, concealing them is impossible, as results manifest within the framework of financial statements.

- **Shareholders:**

Before purchasing company stocks, investors should analyze the company's financial position, including whether it is stable or vulnerable to change, as investing in weak firms poses a financial risk. Thus, a thorough understanding of financial statements and their interpretation is crucial for informed investing

- **Creditors:**

These are the individuals who are most concerned with the financial outcomes of the companies' financial statements. They can provide loans and credit facilities to these companies based on the current situation and results. They assess the risk and the economic unit's ability to repay debts, as well as the interest due during the company's operation and if this unit can pay it. The conclusion is yes or no after reading the financial statements, performing financial analysis, and comparing the statistics.

- **Government:**

The government needs to read these data for zakat and taxes to know the economic situation of these companies and the extent of its impact on national income.

- **Banks**

Banks aim to ensure the safety of the borrowed financial amounts and to assess the clients' ability to regularly repay the accrued interest. Therefore, banks use financial statements to activate oversight over plans, determine the quantity of securities, and present profits and losses.

Concept of Financial Statements

We need to understand the financial statements in order to:

01 — Understanding a customer's ability to settle debt or meet their obligations.

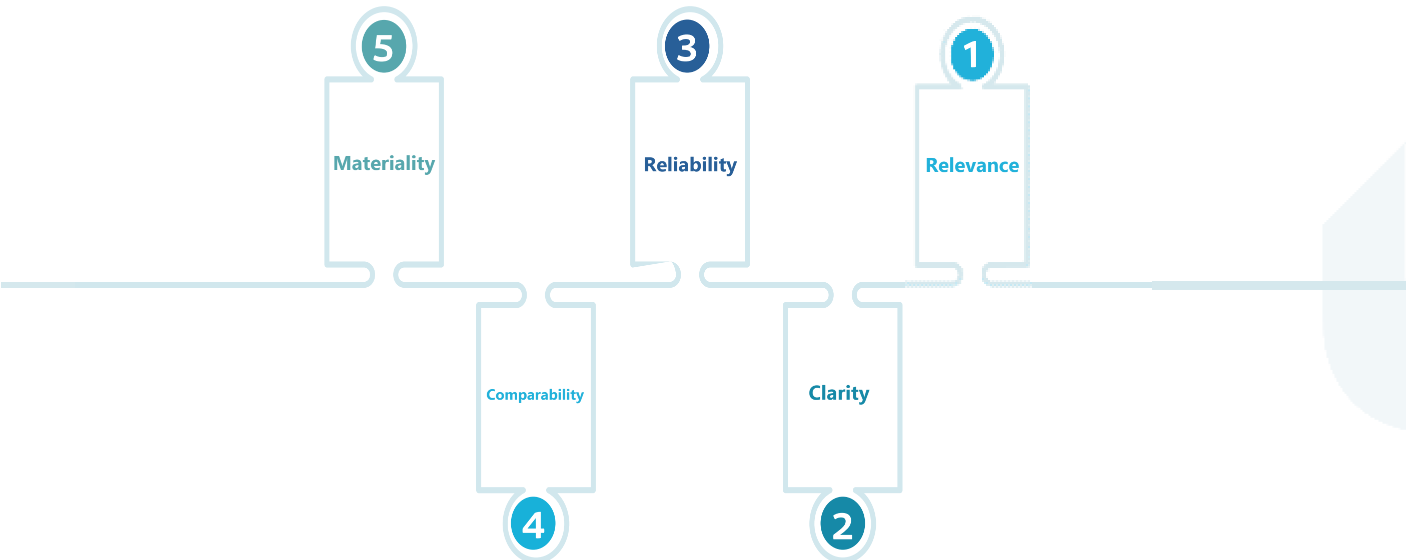
02 — Preserving the company’s capability to conduct its operations and comprehending the figures at hand.

03 — Using numbers in comparing company performance with competing or similar entities

04 — Understanding the numbers accelerates your journey to the top.

05 — Communicating your goals and aspirations through numbers to senior management.

Characteristics of financial statements



Relevance: The financial statements contribute to aiding decision-makers in companies

Clarity: Financial statements collect information on financial operations based on reality

Reliability: It is the availability and validation of information in the financial statements only without affecting other factors

Comparability: The financial statements enable comparison between them in order to assess performance and determine the nature of the financial position's trend.

Materiality: The financial statements contain all the important elements that affect the decision-making process.

Characteristics of Financial Statements

The financial statements aim to:

- Address all relevant parties associated with financial statements, especially current and expected investors and creditors.
- Monitor and review information that works to estimate the magnitude of the risk affecting the company's future cash flows.
- Rely on measures of change in liabilities, in addition to the available resources associated with measuring the income of the entity. This contributes to providing a correct method compared to actual cash flows and forecasting the future.
- Using reliable information on the economic elements of companies to measure weaknesses and strengths and identify sources of investment and funding.

Functions of Financial Statements:

The financial statements depend on the implementation of a range of functions, including:

01 Measuring and evaluating of assets that constitute property for enterprises and projects.

02 Measuring all liabilities for the net value of the assets of enterprises and projects

03 Expressing all components of the financial statements using monetary units as they are the general and basic units in financial measurement.

04 Monitoring on changes affecting the obligations and ownership rights of property and linking them to a specific timeframe and then classifying them as either profits or losses.

Types of Financial Statements

There are four fundamental financial statements, which are:

01 Statement of Financial Position (Balance Sheet)

02 Income Statement

03 Cash Flow Statement

04 Statement of Changes in Equity

- **Statement of Financial Position (Balance Sheet):** It presents the company's resources and obligations towards those resources at the end of the period. Assets include cash, accounts receivable, and inventory. Liabilities encompass accounts payable, loans, and facilities. Equity includes capital, retained earnings, and other reserves.

- **Income Statement:** It includes all the results of the entity's operations during the financial period, such as revenues, sales and administrative expenses, profits and losses, and external revenue and expenses.

- **Cash Flow Statement:** It reveals the sources and uses of cash during the period based on operating, investing, and financing activities. This statement explains how the cash balance changes from the beginning to the end of the period. The ending cash balance in this statement matches the cash balance in the Balance Sheet. This statement shows the company's ability to generate cash on a cash basis, not an accrual basis. It is used to assess companies and calculate cash flows.

- **Statement of Changes in Equity:** This statement shows changes in equity at the beginning and end of the financial period due to company operations, changes in capital (both increments and deduction), regulatory and other reserves, profits not distributed, distributions, and net profit for the period. The final numbers in this statement match the equity figures in the Balance Sheet at the end of the period.

Types of Financial Statements

The accompanying notes to the financial statements are an integral part of the financial statements. They provide detailed information about figures that appear in summarized form in the financial statements. Important aspects include disclosures according to the principle of general disclosure, nature of activities, accounting policies (methods and accounting policies used by the entity), accounting estimates, possible gains and losses, subsequent events, and relationships.

Relationship Between the Four Financial Statements:

- The Income Statement reflects the business results using the resources and financing sources outlined in the Balance Sheet at the beginning of the period. The outcomes of the business activities during the period lead to changes in resources and financing sources, causing modifications in the data of the Balance Sheet at the end of the period. Therefore, it can generally be said that between the Balance Sheet at the beginning and end of the period, there are changes explained by the Income Statement for that period. For instance, the cash balance and accounts receivable (Balance Sheet) change significantly due to cash and credit sales (Income Statement).
- Changes in the elements of the Statement of Financial Position (Balance Sheet): lead to changes in other elements within the same statement.
- Statement of Financial Position (Balance Sheet) items change over different periods in the Income Statement.
- The Cash Flow Statement converts profit on an accrual basis into profit based on a cash basis.
- Elements of the Financial Statements are interconnected or related to each other, compared to previous periods of the same entity or similar comparison with other entities.

Income Statement (Profit and Loss Statement)

The Income Statement can be defined as a statement where revenues are matched against expenses to determine the difference between them, in order to ascertain the profit or loss at the end of the financial period. If revenues exceed expenses, the result is profit, but if expenses are greater than revenues, the result is a loss. The Income Statement is prepared through two methods: either in a summarized manner, known as a single-step Income Statement, or in multiple steps.

Income Statement (Profit and Loss Statement)

Expenses and Extraordinary Losses

These are expenses and losses incurred by the entity as a result of operations and activities unrelated to the main business activity of the company or establishment. Examples include losses resulting from the entity's investment of its funds in the stock market, and losses arising from the sale of fixed assets and so on.

Revenues and Extraordinary Gains

These are revenues or gains obtained by the entity as a result of operations and activities unrelated to the main business activity of the company. Examples include gains achieved through the entity's investment in the stock market, profits resulting from the sale of fixed assets, or from leasing part of its property.

Operating Expenses:

These are expenses incurred by the entity to obtain revenue. They can be divided into administrative and general expenses, such as salaries, wages, electricity, and telephone expenses, and selling and marketing expenses, such as advertising and sales expenses.

Revenues or Net Sales

This term refers to amounts collected from external parties or due from external parties as a result of providing services to them, but the revenues obtained from the sale of goods to external parties are called sales.

Cost of Goods Sold or Cost of Revenues

In service-oriented entities, the cost of revenues represents the expenses directly attributed to the service that contributed to generating revenue. In commercial entities, this is referred to as the cost of goods sold, representing the cost of the goods sold, calculated according to the inventory system used. In manufacturing entities, the cost of revenues represents the cost of raw materials, labor, and manufacturing.

Income Statement (Profit and Loss Statement)

Single-Step Income Statement:

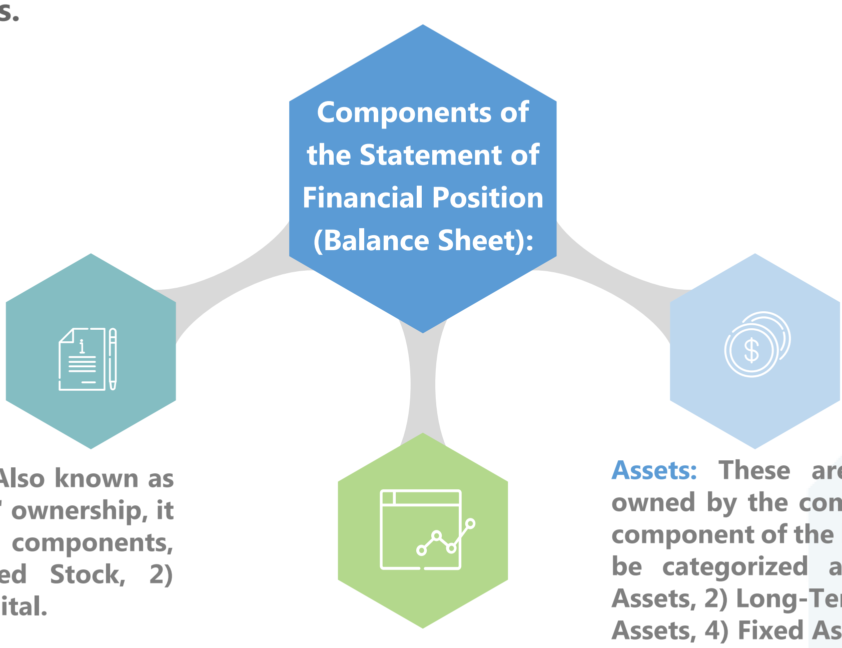
This type of income statement is one of the simplest forms of financial statements. It involves distributing the elements of the income statement into two categories: revenues, whether they are from the main activity or other gains (extraordinary), and expenses, whether they are operating expenses or other (extraordinary) expenses and losses. The difference between the two categories represents the net income or net loss.

Multi-Step Income Statement:

This type is slightly more complex than the first one, but it provides detailed information about income. It presents information about total income, operating income, and net income.

Statement of Financial Position (Balance Sheet)

The balance sheet is a financial statement that summarizes all the assets, liabilities, and shareholders' equity of an entity during a specific period. These three components contribute to clarifying the nature of the entity's ownership and the amounts invested in its various operations.



Shareholders' Equity: Also known as equity or shareholders' ownership, it encompasses several components, including: 1) Preferred Stock, 2) Common Stock, 3) Capital.

Assets: These are the total resources owned by the company and are the first component of the balance sheet. They can be categorized as follows: 1) Current Assets, 2) Long-Term Assets, 3) Intangible Assets, 4) Fixed Assets.

Liabilities: These are the total obligations of the company and are categorized as follows: 1) Current Liabilities, 2) Long-Term Liabilities.

Statement of Financial Position (Balance Sheet)

Benefits of the Statement of Financial Position (Balance Sheet):

This statement provides a range of benefits and advantages to the business environment in various entities, including:
1. Useful financial ratios
2. Providing an overview of operations

Cash Flow Statement

The Cash Flow Statement is a statement that includes all cash inflows and outflows related to the entity, associated with the period indicated in this statement. Cash flows are categorized into: Financing Activities, Investing Activities, and Operating Activities

Statement of Equity

This statement is defined as the obligations owed by the entity to the owner or owners. It is prepared to identify the changes that occurred to the equity of the owners during the period or the fiscal year. Equity increases with capital infusion and profit growth, while it decreases with capital reductions and personal withdrawals as well as losses.

The Statement of Equity includes the following elements:

01 Addition of new capital during the current period, which increases owner's equity

02 Net profit earned during the current period, increasing owner's equity

03 Reduction of capital during the current period, leading to a decrease in the owner’s equity

04 Closing capital balance (net equity), and this account's balance will be shown when preparing the Balance Sheet

05 Opening capital balance

06 Net loss incurred during the period, leading to a decrease in owner's equity

07 Personal withdrawals during the period, leading to a decrease in owner's equity

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