

Understanding your financial statements

Financial statements are important tools which disclose how your business is performing – they are no good if left to ‘gather dust’. They provide insights beyond calculating how much tax you may have to pay. To help you understand your financial statements, we have included an overview of the components which make them up.

Statement of financial position

The statement of financial position (also called a balance sheet) is a statement of what your business owns and what it owes at a particular date. The statement includes assets, liabilities, and shareholders’ funds.

Assets = liabilities + shareholders’ funds.

- ✦ Assets: what your business owns or the resources of your business.
- ✦ Liabilities: what your business owes, eg amounts owing to outside creditors.
- ✦ Shareholders’ funds (or shareholders’ equity or owners’ equity): share capital and profits retained in the business.

Only those items which can be given monetary values are included in the statement of financial position.

Current assets

These are assets which are expected to be realised in cash, sold, or consumed within one year of balance date.

It includes items such as cash on hand and at bank, accounts receivable (debtors), inventory (stock), prepaid expenses, and investments expected to be realised within one year.

Investments

These are assets held to increase your business wealth through either the receipt of distributions, eg interest, royalties, dividends, or capital growth. It can also include other benefits received by your business.

Property, plant, and equipment

These assets are held with the objective of earning revenue, directly or indirectly, and not for the purpose of sale in the ordinary course of business. It includes items such as land, buildings, plant, and equipment.

Other assets

Other assets includes items such as intangibles, eg goodwill, patents, and trademarks, deferred expenditure, and preliminary expenses.

Current liabilities

These are obligations which are expected or could be required to be met within one year of balance date. Items include accounts payable (creditors), accrued expenses, the current portion of long-term liabilities, and bank overdrafts.

Long-term liabilities

These are obligations which are not expected or could not be required to be met within one year of balance date. Items include mortgages and term loans.

Shareholders’ equity

This is the interest of shareholders or owners in the net assets (assets less liabilities) of the business. Items include share capital, capital reserves, revenue reserves, and retained earnings.

Note: These classifications are a general guide and may change with different types of organisations and industries.

Statement of financial performance

The statement of financial performance (also called an income statement, revenue statement, statement of earnings, or profit and loss account) is a statement of the results of your business operations over a particular period of time.

Income – expenses = surplus

Surplus is a measure of your business's performance and is used to pay dividends to shareholders or is retained in the business.

Surpluses retained in the business are included within shareholders' funds.

Sales

Sales are the revenue arising from the delivery or production of goods, or rendering services to a customer.

Cost of goods sold

This is the cost of producing goods for sale, eg labour and materials.

Gross profit

Gross profit is sales less cost of goods sold.

Operating surplus before taxation

This is the excess of all revenues and gains for a period, less all expenses and losses of the period.

Provision for taxation or tax expense

This is an estimate of the amount of tax that will be paid on the reported net profit.

Extraordinary items

These are items which derive from events or transactions that are not expected to occur frequently, are distinct from the ordinary activities of your business, and are outside your control or influence.

Net operating surplus after tax and extraordinary items

This is the bottom line. The final measure of earnings after deducting all expenses.

Statement of movements in equity

The statement of movements in equity is a reconciliation of the equity at the beginning of the period with the equity at the end of the period.

Opening equity

This is the equity carried forward from the prior period.

Net surplus (deficit)

This is the excess of all revenues and gains for a period, less all expenses and losses for the period.

Increase (decrease) in revaluation reserve

This is movement in the reserve resulting from a revaluation of fixed assets.

Other revenues and expenses

These are other items required or permitted to be taken to reserves.

Contributions by owners

These are amounts contributed by owners which do not represent liabilities.

Distributions to owners

These are payments to the owners of the business, eg dividends.

Closing equity

This is the sum of the opening equity and total recognised revenue of a period, less expenses, contributions from owners, and distributions to owners for the same period.

Why is there tax to pay when I have no drawings?

Clients sometimes comment that as they have made no drawings, they do not expect to have any tax to pay. In simple terms, this is because tax is payable not on your drawings, but on the net profit or surplus the business has made.

See Us First

Understanding financial statements can be difficult. We can help explain complex tax and financial issues in plain English.

Disclaimer

Important: This is not advice. Clients should not act solely on the basis of the material contained in this fact sheet. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. We believe the contents to be true and accurate as at the date of writing but can give no assurances or warranty regarding the accuracy, currency or applicability of any of the contents. This fact sheet is made available to our clients as a helpful guide for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval.