المركز الإحصائي
لدول مجلس التعاون لدول الخليج العربية
GCC-STAT

GCCSTAT – Importance of Financial Statements

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Introduction – What is the need for financial statements of companies?

- Firstly, the financial statements are necessary to validate data reported on a survey by respondents;
- Even with the best of intentions, a respondent may not correctly answer some questions because he does not understand the question, does not read the instructions carefully, misunderstands the question or has his own interpretation of a term (e.g. associate)

Introduction – What is the need for financial statements of companies? (contd)

- Secondly, they are needed to construct data when some companies do not respond
- Thirdly, they are needed as part of a strategy of data collection that takes into account the convenience to and cooperation of the respondents.
- FDI questionnaires have become more complex with every revision of IMF's manuals on balance of payments

Introduction – What is the need for financial statements of companies? (contd)

- For a company's accountant, filling out a FDI survey is not a top priority even if he is a conscientious employee;
- Just because there is legislation with penalties prescribed for non-compliance, does not mean that government agencies should impose unnecessary reporting burdens on companies;
- Companies will respond better when they see the government agencies taking appropriate measures to shoulder the burden of reporting

Introduction – What is the need for financial statements of companies? (contd)

- GCC countries' companies are among the most conscientious respondents to surveys when compared to most individual countries or group of countries in the world;
- Yet this factor should not be taken advantage of by governmental agencies who should also play an active part in responding to their own surveys.
- How is the above done?
- It is through use of the financial statements to fill out what they can from the financial statements and then send the questionnaires to the companies for filling the missing data

The various types of financial statements

- There are various types of financial statements, all of which are useful for the FDI statisticians;
- One does not have to be a qualified accountant to understand the basics of these financial statements;
- So, do not worry if you had never taken a course on accounting and the mention of accounting stresses you;
- Whatever you need to learn, we will hopefully learn during this lecture;

The various types of financial statements (contd)

- Firstly, there is the Statement of Financial Position, also called the Balance Sheet;
- Secondly, there is the Statement of Comprehensive Income, also called the Income Statement or Profit and Loss Account;
- Thirdly, there is the Statement of Cash Flows
- Fourthly, there is the Statement of Changes in Equity

Statement of Financial Position

- Statement of Financial Position or Balance Sheet shows the financial position of a company at a point of time;
- The point of time chosen is usually the end of the fiscal year;
- The fiscal year refers to a 12 months period which may or may not coincide with the calendar year;

Statement of Financial Position (contd)

- Most companies choose to operate on a calendar year basis;
- But companies do not always choose a calendar year;
- In the Western countries, a number of retail companies choose January as their year end since they want to incorporate the performance of the month of December as soon as possible in their financial statements since December is their busiest month;

Statement of Financial Position (contd)

- If the financial year ends in December, the balance sheet will state "At 31 December, 2018".
- This means that at the point of time 31 December, 2018, such and such was the financial position of the company.
- So, what is the financial position of a company?

Composition of the financial position of a company

- A balance sheet consists of two main components- assets and liabilities;
- Liabilities are subdivided into two major categories – (a) Equity which is liabilities to shareholders on account of their shareholdings (b) other liabilities on account of debt both to shareholders and others;
- Assets and other liabilities are further subdivided into (a) non-current assets or non-current liabilities which signify that they are long-term or over a year at that point of time or (b) current assets and liabilities which are short-term or less than one year at that point of time

Composition of the financial position of a company - Assets

- Non-current assets (long-term) may be further sub-divided into (a) Property, plant and equipment (b) Long-term receivables © Derivative financial instruments (d)goodwill and (e)other assets;
- Current assets include (a) Inventories (b) Current portion of long term receivables © Accounts receivable and prepayments (d) Derivative financial instruments (e) Other assets (f) Bank balances and cash
- Non-current assets and current assets will equal total assets.

Composition of the financial position of a company – Liabilities (ex. Equity)

- Non-current liabilities – (a) Borrowings (b) Derivative financial instruments © Employees' end of service benefits;
- Current liabilities – (a) Borrowings (b) Accounts payables and accruals © Derivative financial instruments
- Non-current liabilities and current liabilties total liabilities (ex. Equity)

Composition of the financial position of a company – Liabilities - Equity

- Equity consists of (a) Share capital (b) Treasury shares © Various reserves (d) Retained earnings (e) Proposed dividend
- Share capital consists of (i) Authorized shares and (ii) Issued and fully paid shares
- What is reflected in the equity account is the issued and fully paid shares

Composition of the financial position of a company – Liabilities - Equity

- Treasury shares – From time to time, a company may purchase issued and fully paid shares from existing shareholders for various corporate purposes. When this is done, the purchased shares are held in the Treasury of the company. This has the effect of reducing the value of existing share capital. Hence the values of these shares are shown as a negative value in the equity account.

Composition of the financial position of a company – Liabilities – Equity (cntd)

- There are various kinds of reserves such as (a) Statutory reserves (b) Capital reserves
- For example, in various middle eastern countries (e.g. Egypt, Bahrain) Commercial Companies Laws require companies to transfer 10% of their annual profit to a statutory reserve until the reserve equals 50% of the paid up capital. This reserve cannot be utilized for the purpose of dividends except as stipulated in the Commercial Companies Law

Composition of the financial position of a company – Liabilities – Equity (cntd)

- Capital reserves are created from the surplus on disposal of property, plant and equipment in prior years. This reserve is distributable subject to the approval of shareholders. These are distributed as return of capital and not as dividends. Shareholders will not have to pay taxes on these distributions as they would pay on dividends. They will pay taxes related to capital gains or their cost of investments will be reduced by the amounts of distributions

Composition of the financial position of a company – Liabilities – Equity (cntd)

- Retained earnings are past earnings that have not yet been distributed to shareholders, transferred to the proposed dividend account or to any of the reserves. These earnings arise not only from the normal operations of a company’s business but also from other factors such as foreign exchange gains and losses, write offs, re-valuations of assets etc. These will be reflected in retained earnings unless they are shown in special reserve accounts such as capital reserves.

Composition of the financial position of a company – Liabilities – Equity (cntd)

Proposed dividend – During the course of a year, a company may propose the payment of a dividend which may not be paid until the following year when the Board of Directors approves the payment. When the dividend is proposed, it is taken out of retained earnings and put into the proposed dividend account in equity. Some companies instead may show the dividends payable in the short term accounts payable in other liabilities

Statement of Comprehensive Income

- Also called Profit and Loss Account or Income account;
- Prepared for the whole fiscal year and statement would indicate e.g. Year ended 31 December 2018;
- Some statements may show more details than others;
- If significant details not shown in main statement, they may be shown in notes to the financial statements

Statement of Comprehensive Income (contd)

- For e.g. the income statement of a company shows the total sales data. It does not differentiate the different products, exports and domestic sales or sales to related parties and others, all of which are important for policy makers and analysts of FDI data'
- But in a note to the statement, it may give all these details.

Statement of Comprehensive Income (contd)

- In a significant company in a GCC country, the following data were given: Sales destination: Domestic (42%); Exports (58%)
- Ratios of exports to total sales by geographic regions were as follows: Rest of the Middle East and North Africa (21%); Europe (19%); Asia (13%); Americas (5%).
- Sales to two customers of the Company amounted to 34% of total, each being more than 10% of the total sales revenue
- Exports is one of the data sought by Users of Foreign Affiliates Statistics (FATS) or by the UNCTAD in Activities of the MNEs (AMNEs); in most cases, this data can be directly obtained from the P&L statement;

Statement of Comprehensive Income (contd)

- Another data sought is exports to foreign direct investors. This will be given in the notes to the financial statement since it is a transaction with a related party

Related Parties

- Who are related parties?
- Related parties represent major shareholders, directors and key personnel of the Company and entities controlled or significantly influenced by such parties. Pricing policies and terms of these transactions are approved by the Company's Board of Directors.

Positions/Transactions with related parties (including fellow enterprises) related to assets (contd)

- There is a difference in treatment of payments of loans between accountants and BOP statisticians;
- Any loan amount payable within 12 months (whether long or short) is shown as current liabilities by accountants;
- If it is repayment of a long term loan, BOP statisticians will show it as long term;

Positions/Transactions with related parties (including fellow enterprises) related to assets (contd)

- Therefore, as FIS/BOP statisticians, you will add the current portion of long term payable shown in current liabilities to the amount shown in long term payable every year;

Derivative Financial Instruments

- A derivative is a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes;
- Unlike debt instruments, no principal amount is advanced to be repaid and no investment income accrues;
- Companies enter into derivative transactions to hedge economic risks under risk management guidelines. These transactions are entered into so as to protect the company against any perceived risks in exchange rates of currencies, interest rates (especially of floating rates) or commodity prices turning negatively to the financial well being of the company;
- When these derivatives are set up, they are neutral;
- From that point on, they could be favorable to the company (assets) or unfavorable to the company (liabilities)

Derivative Financial Instruments (contd)

- A fair valuation is made of the existing derivative financial instruments at the end of the financial year and the results are taken to the statement of comprehensive income.
- Also any realized amounts are also taken to the statement of comprehensive income;

Remuneration of employees

- Remuneration of employees is one of the FATS/AMNEs data required;
- Remuneration of employees include both wages and benefits;
- Remuneration of employees not explicitly stated in the Statement of Comprehensive Income;
- They are included as components in various accounts such as cost of sales, selling and distribution expenses and administrative expenses;

Statement of Cash Flows

- This is the third type of financial statement of a company.
- It enumerates the cash flows of the compny during the year that would explain the change in cash and cash equivalents at the end of a particular year to the end of the previous year.
- Its relationship to the Balance Sheet is the item shown as bank balances and cash in the current assets of the balance sheet.

Statement of Changes in Equity

- This is the fourth of the financial statement of a company;
- As the title of this statement says, it shows all the changes effected to the equity of a company;
- First, equity changes as a result of the net profit or loss incurred by a company during the accounting period (year/quarter);

Statement of Changes in Equity (contd)

- Secondly, equity changes as a result of the payment of dividends;
- Thirdly, changes are effected as a result of purchases or sale of treasury shares;
- Fourthly, changes are effected if funds are moved in/out of statutory and capital reserves;
- After all these changes are effected, the balance at year end will equal the total shown for equity in the balance sheet.

Commercial Registration Information

- Commercial Registration Information is not part of the financial statements of a company;
- It is information provided by the company when it is registered with Government authorities;
- In practically all countries where such requirements exist, companies are expected to inform authorities of changes when they occur;

Commercial Registration Information (contd)

- These changes may vary from address changes, to changes of officials, changes of shareholders etc;
- The ministries or agencies responsible for registration could be the Ministry of Commerce and Trade or an Agency that facilitates investments (both domestic and foreign)
- In practice however, after the original registration, attempts are not made consistently to update changes;

Commercial Registration Information (contd)

- If information is updated, there is valuable data for FDI statisticians;
- Not sure whether every company updates the information and whether authorities follow up on non-respondents;
- Information available includes company type, registration date, financial year end, address, email, phone and fax numbers, names of authorized signatories and Board of Directors, description of business codes and industrial classifications, history of major events related to the company such as capital increases, new activities, and transfer of ownership;

Commercial Registration Information (contd)

- Very important information available from it to the FDI statistician is the company's capital details and the major shareholders and the number of the shares that they own;

Commercial Registration Information (contd)

- The company would have a register of its shareholders since it has to communicate with its shareholders for purpose of informing them about shareholders' meetings and payment of dividends;
- Again for practical reasons, a company may not go beyond the nominee holders (investment funds, brokerages and banks);
- These nominee holders in turn would communicate with the ultimate shareholders;

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