Annual Financial Statement

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The annual financial statements include the balance sheet and the profit and loss account. Incorporated companies are additionally required to draw up notes (giving explanations n individual balance sheet and P&L items) as well as a management report which must present the company's business developments and its current position in a way that gives a true and fair picture of a company's assets, financial position and earnings situation.

# Balance Sheet

The first part of the system of the annual financial statements is the Balance Sheet, or more precise, the Balance Sheet Comparison.

The Balance Sheet is similar to a table and consists of two sides presenting a company's assets and capital at a specific point in time. The assets are shown on the left-hand side and the capital is shown on the right-hand side of the balance sheet.

The Assets can be separated into Fixed Assets and Current Assets. Fixed Assets serve the company over a longer period (more than one year), for example buildings, office furniture and vehicles. Current assets include all assets that serve the company in the short term; they are used, processed or sold. Current assets include for example cash in hand, cash at bank and the stock.

The sum totals of the two sides must always be the same because the company's assets must have been financed from either the company's capital (Equity Capital) or by Borrowed Capital.

|  |  |
| --- | --- |
| **Assets** | **Equity and Liabilities** |
| Fixed Assets | Equity Capital |
| Current Assets | Borrowed Capital |
| **Total Assets** | **Total Equity and Liabilities** |

Example:

|  |  |
| --- | --- |
| **Assets** | **Equity and Liabilities** |
| Office furniture 30 000€Fixed AssetsCurrent AssetsMachinery 60 000€ | Equity Capital 70 000€ |
| Stock 15 000€Liquid Funds 10 000€  | Borrowed Capital 45 000€ |
| **Total Assets 115 000€** | **Total Equity and Liabilities 115 000€** |

 must be the same value

## Calculating the profit:

For calculating the profit, the company's equity capital at the end of the year (closing balance sheet) has to be compared to the equity capital at the beginning of the year (opening balance sheet).

|  |  |
| --- | --- |
|  | Equity capital (closing balance sheet) |
| – | Equity capital (opening balance sheet) |
| = | Annual result (profit or loss) |

Example:

|  |  |
| --- | --- |
|  | 70 000€ (Equity capital 31.12.2010) |
| – | 30 000€ (Equity capital 01.01.2010)  |
| =  | 40 000€ (Profit over the Year) |

# Profit and Loss Account

In the profit and loss account, which is the second part of the system of the annual financial statement, the annual result is calculated by offsetting expenses against income. If the income is higher than the expenses, the company generated a profit. If expenses are higher, the company made a loss.

The profit and loss account also provides information on how a profit or loss was generated. It summarizes all transactions that contributed to making the company poorer or richer during the financial year.

Like the balance sheet, the profit and loss account consists of a table. On the left-hand side the expenses are listed, while the income is located on the right-hand side.

|  |  |
| --- | --- |
| Expenses | Income |
| Material 80 000€Personnel Costs 60 000€Rental fees 20 000€New company car 30 000€ | Sales Revenues 220 000€Income from Investments 10 000€ |
| Total Expenses 190 000€ | Total Income 230 000€ |

## Calculating the profit:

The annual result is calculated by offsetting expenses against income.

|  |  |
| --- | --- |
|  | Income |
| – | Expenses |
| = | Annual result (profit or loss) |

Example:

|  |  |
| --- | --- |
|  | 230 000€ |
| – | 190 000€ |
| = |  40 000€ (profit) |

# Profit and Loss Account in Report Form

The Profit and Loss Account in Report Form immediately makes it clear in which business areas a company generated a profit or loss. Income and expense items are shown one after the other by source of income and type of expense. This approach helps to increase transparency and makes the P&L account more easily and understandable.

|  |  |  |
| --- | --- | --- |
|  | Operating income | Income from core business |
| - | Operating expenses | Expenses from core business |
| = | Operating result | Profit or loss from core business |
| +/- | Financial result | Income and expenses from securities, investments,... |
| = | Profit/Loss on ordinary activities |  |
| +/- | Extraordinary result | Extraordinary or non-recurrent events |
| = | Profit/loss before taxes | Pre-tax profit/loss |
| - | Income taxes |  |
| = | Net profit/loss of the year |  |
| +/- | Allocation to reserves |  |
| = | Distributable Profit |  |

Example:

|  |  |  |
| --- | --- | --- |
|  | 220 000€ | Operating income |
| - | 160 000€ | Operating expenses |
| = |  60 000€ | Operating result |
| + |  10 000€ | Financial result |
| = |  70 000€ | Profit/Loss on ordinary activities |
| - |  30 000€ | Extraordinary result (new company car) |
| = |  40 000€ | Profit/loss before taxes |
| - |  10 000€ | Income taxes |
| = |  30 000€ | Net profit/loss of the year |
| - |  10 000€ | Allocation to reserves |
| = |  20 000€ | Distributable Profit |

# Receipts and Invoices

The supreme principle in accounting is that no book entry may be made without a receipt or invoice. Every single transaction must be documented in writing. Companies are obliged by law to collect all receipts and invoices, enter them in the books and store them for at least 7 years (in Austria). An exception are receipts and invoices below 300€, which do not have to get stored.

# Possible Questions

* *What is the difference between liquid funds and equity capital?*

The equity capital is the part of the company which belongs to the owner/the company itself, while the liquid funds represent a company's cash resources. In general, the liquid funds include the cash at hand and cash at bank, but it may extend to certain securities and short-term accounts receivable. (Order of liquidating: cash -> securities -> Short-term accs rec. -> inventories -> fixed assets)

* *Why is the balance sheet balanced?*

The total assets and the total equity and liabilities must be the same value, because all the assets are financed by the capitals - either by equity capital or by borrowed capital.

* *What is the basis of the balance sheet?*

The basis of the balance sheet is the inventory / stocktaking: Determining the assets and debts of a company by counting and valuating all the company's assets and debts at the end of the financial year.

1. Determining all the assets
2. Determining the borrowed capital (debts)
3. Equity capital = total assets - debts
* *What do you do in the P&L account in general?*

You set off the expenses from the income in order to calculate the profit.

* *At the end of the year, the company owner wants to reduce taxes. How can he do this?*

He can reduce the taxes by reducing the company's profit shown the the annual financial statement.

One possibility are purchases with a lasting equivalent value, for example a company car or machinery. These purchases generate expenses over more years (depreciation reduces the profit).

But there are some exceptions: Purchases below 400€ can be written off completely in a year. And there are also purchases without a lasting equivalent, e.g. an advertising campaign.

* What are accounts receivable?

We speak of an account receivable if a customer has been invoiced for a product or service provided but has not yet settled this account. Accounts receivable are part of the current assets and are shown on the left-hand side of the balance sheet.

* What are accounts payable?

Accounts payable are debts a company has to a supplier because an already issued invoice for goods or services provided has not yet been settled. Accounts payable are part of the borrowed capital and are shown on the right-hand side of the balances sheet.