Financial statement differentiation research paper

Business, Company

Income Statement

The income statement reports on the primary yardstick of business performance, net income. While the common term used is profit, accountants normally prefer to use the term net income. Additionally, it also shows the expenses and costs incurred by the company to earn the incomes over the same period. However, the bottom line of the statement is the net income which indicates profitability of the company in terms of investments.

Balance Sheet

A balance sheet is essentially a detailed report on a company's liabilities, assets and shareholders equity. Assets can be raw materials for making final products to be sold or final products that can be sold. Liabilities refer to the amounts owed to others by the company. They include obligations such as bank loans, money owed to the company suppliers among others. Finally shareholders equity also referred to as net worth or capital refers to the amounts that would be left to the shareholders in the event the company disposed of all of its assets and used the returns to pay their creditors. The formula below summarizes what a balance sheet entails

ASSETS = LIABILITIES + SHAREHOLDERS' EQUITY

Cash Flow Statements

Cash flow statements report on the inflows and outflows of cash within the company. This therefore shows the liquidity position of the company to enable it operate efficiently. It essentially shows the changes that occur over time by using information from the balance sheet and the income statement. It is the cash flow that shows whether the company has generated cash for the company to enhance its operations. Generally, the statement is normally divided into cash from operating, investing and financing activities.

The statement of cash flows helps investors, creditors, and others to analyze the cash effects of a company's operating, investing, and financing activities (Kimmel et al., 2009)..

Statement of Retained Earnings

This financial statement reports on the changes to the equity segment of the balance sheet. This includes: retained earnings, other comprehensive income and common and preferred stock. Retained earnings is the net income retained in the corporation, so this statement shows amounts and causes of changes in these earnings (Kimmel et al., 2009). Retained earnings normally appear on the balance sheet and are on most occasions affected by dividends and income. This relationship can best be shown by the equation Beginning Retained Earnings + Net Income – Dividends = Ending Retained Earnings

Financial statements for external users

1. Which financial statement, or statements, would be of most interest to investors?

Income statement and balance sheet are the most interesting statements for investors, because they reflect overall situation and provide information about assets, liquidity, liability and also revenues. Investors are looking for such information as profitability, liquidity, financial leverage and asset turnover ratios, all of which can be calculated on the basis of data from the income statement and the balance sheet.

2. Which financial statement, or statements, would be of most interest to creditors?

Creditors such as suppliers and bankers use accounting information to evaluate the risks of selling on credit or lending money (Kimmel et al., 2009). Creditors look at the income statement to predict future earnings and at the balance sheet to determine the likelihood that loans will be repaid. However, the most important is the statement of cash flows, because it simplifies creditor's search. While company may be profitable according to their income statement, poor collections of receivables may signalize the opposite.

3. Which financial statement, or statements, would be of most interest to management?

Management needs to have general overview of company's health. It is a tool to use in order to analyze financial position of the company or organization, and adapt management decisions to cope with issue if any. Above all, management is interested in the cash flow and retained earnings statements. However, it is important to keep general overview and track income statement and balance sheet as well, which are important for one year or longer financial planning.

References

Kimmel, P. D., Weygandt, J. J., & Kieso, D. E. (2009). Accounting: Tools for business decision making (3rd ed.). Hoboken, NJ: John Wiley & Sons