Income Statement

<u>What does the income statement represent?</u>

The ***income statement*** (*or 'the statement of operations' or 'the profit and loss account'*) measures the operating performance of a company over a time period such as a year or a quarter.

The long-term objective of any business is to turn the cash from ***capital providers*** (*equity holders or lenders*) into more cash. If the company is to stay in business, this excess cash must be generated by the operations (*i.e., the activities for which the business was initially established*).

The cycle consists of three stages:

1. Purchasing the inventory
2. Selling the inventory
3. Collecting cash from the customers

Until the company ceases to exist, the operating cycle is repeated continuously.
The operating cycle varies from business to business. Information is needed by various stakeholders in the company, such as the management or the capital providers, about how the business is performing periodically.
Managers know that reducing the time needed to turn cash into more cash means better operating performance through generating greater profits and higher growth.

The income statement displays a company's revenues and expenses over time and shows the company's ability to generate profit by increasing revenue and reducing costs. It is important in assessing the financial performance of a company over time.

Take a closer look at these components below:

1. ***<u>Revenue -</u>*** This refers to the total income earned by the company from its operations during the period. It includes sales revenue and any other income like interest, dividends etc.
2. ***<u>Expenses -</u>*** These are costs incurred by the company during the period, for example: cost of goods sold, salaries, rent, utilities, taxes, interest etc.
3. ***<u>Profit/Loss -</u>*** This is the residual earnings after deducting all expenses from revenue. It represents the net income or net loss made by the company over the specified period

The ***<u>cash flow statement</u>*** brings the income statement and balance sheet together to *provide a dynamic view of the way a company generates and uses cash.* The purpose of the statement of cash flows is to help assess whether the business is sustainable.
i.e : the statement of cash flows also shows how cash deficits are financed, or cash surplus is distributed.