Financial statement

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Financial statement is a collection of reports on the company's business. It is made once every accounting period, according to the accounting law. Usually, an accounting period lasts for 12 months. In the financial statement, the company's finance is described numerically via three different aspects of accounting: **income statement, balance sheet**, and **cash flow statement**. On top of these statements, financial report consists of report of the directors and complimenting attachments. The financial statement should give a sufficient image on the income of the company and the quality and scope of its business.

Financial statement is a public document, which means it is an important source of information for all the stakeholders of the company. The reports are also a basis for the terminology used internally in the businesses. With the terms used in the financial statement, one can define different performance indicators that are used in assessing the evolution of the company, and in comparing the company with its peers. This is why knowing the structure of the statements and the main terminology is a fundament of IEM studies.

Income statement

Income statement gives an insight into how the profit / loss of a company is formed during an accounting period. The statement begins with the business revenues. First, one needs to subtract the expenses of running a business. What you have as a result is the operating profit that illustrates profitability of business. One then subtracts the financing costs, resulting in earnings before taxes (EBT). When subtracting the income tax, one then gets the final figure - net income for the period. Many variations of income statements exist, but these are the key components in all of them.

REVENUES	Revenues from selling the product or the service, where discounts, value added tax (VAT) and other immediate sales-based taxes are subtracted. (Book profit on realization)
- Operating expenses	Materials and services the company has bought, electricity bills (and the like), wages of the personnel, rent, depreciations.
= EARNINGS BEFORE INTEREST AND TAXES (EBIT)	Indicates how much of the revenues are left, once the expenses of running the business are subtracted. Independent of capital structure.
- Interest	Payment for the loans. Depends on the amount of debt.
= EARNINGS BEFORE TAXES (EBT)	

- Income tax	The amount of taxes can be counted by multiplying EBT with corporation income tax percentage, with is 20 % in Finland.
= NET INCOME	Can be positive (profit) or negative (loss).

Example on income accounting

Company has delivered products worth 50 000 €. In total, the material expenses are 20 000 €. The wages, rent, and electricity are 10 000 € in total. The amount of investments of the company is 50 000 €, and all these investments are deprecated in 5 years as straight-line depreciations. The company has a debt of 100 000 €, and it's paying an interest of 5 % / year. The income tax is 20 %.

REVENUES	*50000*
Business expenses	*−30000*
OPERATING MARGIN = EBITDA (earnings before interest, taxes, depreciation and amortization)	*20000*
Depreciations	*−10000*
OPERATING PROFIT = EBIT	*10000*
Interest	*−5000*
EBT	*5000*
Taxes	*−1000*
NET INCOME	*4000*

Balance sheet

Balance sheet is a representation of the financial state of the account closing date: the value of the company's assets (total assets), and the debts and equity of the company (total liabilities and shareholders' equity). The basic structure of the balance sheet can be illustrated as the balance sheet equation:

Total assets = Liabilities + Shareholders' Equity

Accounting regulation defines, how assets, debts, and equity should be classified. Assets can be divided roughly in three categories: fixed assets, stocks, and liquid assets.

Companies have different kinds of debt claims, whose common name in the balance sheet is liabilities (outside capital). It is divided into short- and long-term. Long-term debt matures in a timeframe that is longer than a year. Other debts are short-term. Consequently, the company needs to present the following year's amortization of the long-term debt as a short-term debt.

As for equity, it is necessary to divide the owner's direct financing for the company (share capital) and the periodic net profits. The net profit in the income statement indicates, how much a company has succeeded in increasing the value of its equity. This is one example of how financial statement and balance sheet are intertwined.

TOTAL ASSETS	Yrityksen omaisuus
Non-current assets	Assets that make profit during several accounting periods.
Fixed assets – Property and equipment	Category of assets defined in the occupational tax law – includes buildings, machines, equipment, land, patents and securities.
Net current assets	Assets not included in non-current assets
Stocks	Ingredients, semi-finished products and finished products that can be sold or refined.
Ingredients	Unprocessed materials
Products in process	
Finished products	Products ready to be delivered
Liquid assets	Money needed for running the normal business, and debts
Receivable accounts	Payments for delivered products and services the company is yet to receive
Disposable assets	Yrityksen rahavarat. Niiden määrä lasketaan rahavirtalaskelmissa The company's financial resources. Accounted in the cash flow statement

TOTAL LIABILITIES	Describes how the company has attained its capital
Shareholders' equity	Capital the company is not obligated to pay back
Common stock	Amount of money the shareholders have invested directly in the company
Retained earnings	

	Total of the net incomes from previous years, where the shareholders' dividends have been subtracted.
Net income	Outcome of current year's business (can be seen in the income statement)
Current liabilities	Total amount of debts
Long-term debt	Debts maturing in more than one year
Bank loan	Loans of the company, where the next amortization is subtracted
Short-term debt	Debts maturing during the next accounting period
Amortization of the next accounting period	
Accounts payable	Payments of received materials and services the company is yet to pay

Cash flow statement

The cash flow statement categorizes three different liquidity flows during the accounting period:

Operating activities describes to which extent the company has been able to produce liquid assets with its business. These are used in order to maintain the business operations, make new investments, and pay amortizations and return to shareholders without taking debt.

Investing activities describes how much the company has spent its liquid assets for investments that maintain or frow the business

Financing activities describes how much the company has factually paid returns, amortizations, and raised a loan from external sources of financing.

If the sum of the cash flows describes above is positive (negative), the liquid assets have increased (decreased) during the accounting period worth the same amount. If all the company's liquid assets were on a single bank account, the sum of the cash flows would equal to the change in the balance of the account. Cash flows are intertwined with the balance sheet through the change in the liquid assets.

	OPERATION ACTIVITIES
+	INVESTING ACTIVITIES
+	FINANCING ACTIVITIES
=	NET INCREASE / DECREASE IN CASH

	Disposable assets at the beginning of the accounting period
+	NET INCREASE / DECREASE
=	Disposable assets at the end of the accounting period

The income statement and the cash flow statement are interconnected, too. The same business events affect both statements but aren't necessarily considered during the same accounting period. This is caused by fundamental differences between how income and expenses are booked and how expenses are deferred. **Net income and net increase in cash flows mean different things.**

In the income statement, one must follow the so-called **accruals principle**, according to which the basis for booking an expense is the receival of a production factor, and booking an income is based on handing out the performance. On the other hand, the cash flow statement is put together using the **cash basis method**, where business activity is booked on the accounting period, where the company has received the payment for the performance it has handed out or paid for a production factor it has received.

In the income statement, the expenses that probably will not create value, will be subtracted from the accruals-based revenues. This causes a need for carrying forward expenses in the income statement. For instance, if the company has purchased and paid an item of goods that is still sitting in the storage at the end of the accounting period, the expense of the purchase is not subtracted from the revenues of that accounting period. The subtraction will be carried out once the item of goods is sold and delivered to a customer.

Depreciation is a term that is closely related to the concept of carrying forward the expenses of purchasing fixed assets and spreading them across many accounting periods in the income statement. For example, the expense of purchasing a machine shows as a single sum of money in the cash-based cash flow statement, in the investing activities. However, in the income statement, the expense is subtracted from the revenues during several accounting periods. The reason for this is that the machine will also produce revenues during these accounting periods. The periodically subtracted slice of the expense is called a depreciation. The non-subtracted part of the machine shows in the balance sheet as the machine's book value.

Income statement, balance sheet, and cash flow statement provide a holistic view in the financial state of the company. Even though there exists fundamental differences in how income- and cash flow statements are made, the examples provided above point out that these documents definitely are not disconnected from each other.