What Are Financial Statements?

Business owners use three basic financial statements to track the financial health of there businesses. These statements are the income statement, the cash flow statement, and the balance sheet. Business owners generally create these statements monthly using their financial records.

# The Income Statement

An income statement is a financial statement used to show whether a business is generating a proft or experiencing a loss. This is done by identifying all the money coming into the business, which is usually the revenue generated by day-to-day sales. Then all the money going out of the business is identified; these are all the bills that must be paid to maintain the business. To determine net profit or loss, the business owner subtracts the expenses from the revenues. If this number is positive—meaning, the revenues are greater than the expenses—the business is generating a profit. If the number is negtive—meaning the expenses are greater than the revenues—the business is experiencing a loss.

There are several parts of an income statement. These include revenue, cost of goods/services sold, gross profit, fixed operating costs, pre-tax profit, taxes, and net profit(loss). In Figure 1 below, you can see an example of a simple income statement for a company that sells name badge holders. This income statement allows you to see the business is profitable, and how profitable.[[1]](#footnote-1)

# The Cash Flow Statement

The cash flow statement shows cash receipts less cash disbursements over a period of time, generally a month. The first section of a cash flow statement shows all sources of income for the month. The second section shows all cash disbursed by the business for that month. The last section shows the net change in cash flow. This shows the owner whether the business had a positive or negative cash flow for the month. This is vital information because it is possible to have large sales volume and still not have enough cash to cover monthly expenses. Figure 2 below provides an example of a cash flow statement.

# The Balance Sheet

A balance sheet is a financial statement that is divided into three sections: assets, liabilities, and owner’s equity. Assets are what the business owns, liabilities are what the business owes, and owner’s equity is the net worth of the company. Net worth is the difference between assets and liabilities, and shows the amount of capital in the business.

Typical assets for a business include cash, inventory, and capital equipment, but can include any item the business owns. There are two types of liabilities—short-term and long-term. Liabilities that must be paid within the year are considered to be short-term; long-term liabilities are ones that can be paid over periods longer than one year. Once assets and liabilities have been identified, the owner’s equity can be computed. On a balance sheet, assets must equal the sum of liabilities and owner’s equity. An example of a balance sheet for Name Badges with Pizzazz might look like the one in Figure 3.

# Examples

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1. Entrepreneurship, 2/E; Steve Mariott and Caroline Glackin; Pearson Education, Inc.; Upper Saddle River, NJ; 2010; pages 222–228, 256–259 [↑](#footnote-ref-1)