

FINANCE AT A GLANCE

Putting the Balance Sheet and the Income Statement in Perspective

Lesson 33

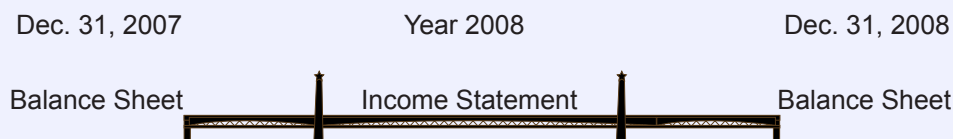
In all of the previous lessons, we looked at two of the basic financial statements --- the balance sheet and the income statement. We looked into their logic, defined their components, and showed the relationship of one statement to the other.

In this lesson, we shall have an overview of these two statements before we move on to more details.

The balance sheet presents the financial position of a business *at a particular point in time*. Here we emphasize the phrase “at a particular point in time”. Notice that in previous examples of balance sheets, it always stated “As of _____ (date)”. The date mentioned is the particular point in time, at which we look at what a company *owns*, what it *owes*, and what is left to the business owners. Looking at the balance sheet is like looking at a snapshot, where the action is frozen. It shows how rich or how poor a business is, but it does not tell us how the company got to that position.

The income statement, on the other hand, shows how the company performed *over a particular period of time*. Here we emphasize the phrase “over a particular period of time”. Notice that in example of income statements, it always stated “For the year ending _____ (date)”. The year referred to was the period being considered. The income statement shows how the business earned money and how much, how it spent that money, and what it had left after paying for all of the expenses. Looking at the income statement is like watching a motion picture, and seeing what transpired over a certain period. It shows how well or how poorly the company did over such period.

Putting these in perspective, we say that actions in the motion picture that we see in the income statement started with the snapshot in the balance as of the beginning of a period, and ended with snapshot in the balance sheet as of the end of that period. The income statement is like a bridge between two balance sheets.



The balance sheet and the income statement tell us two different things about a business. A business may be making a lot of profits, as shown by its income statement, but then its balance sheets show that it is heavily in debt. Analyzing the overall finances of a business needs an understanding of both of these financial statements.

We hope that as of this point in our discussion, we have imparted a basic understanding of financial statements, and that we have convinced you that an accounting background is not essential to understand them.

Until the next lesson,

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