

THE INCOME STATEMENT: CONCEPT AND PRINCIPLES

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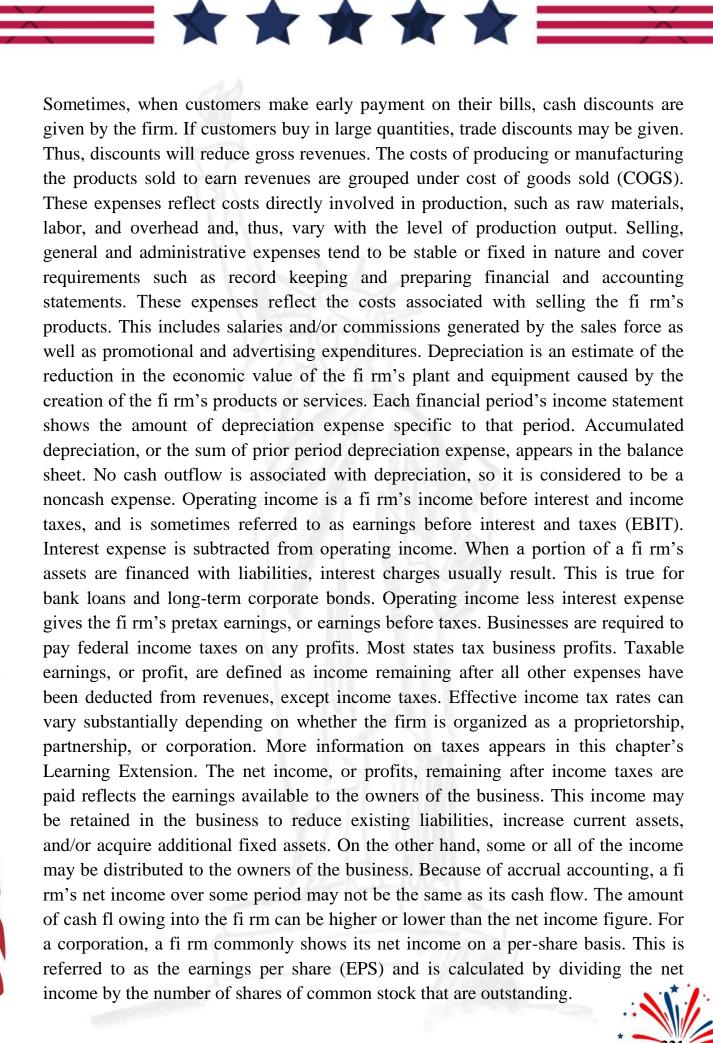
Abstract: This article provides a practical analysis of the practical application of the income statement and the problems in the transition to international financial reporting standards and ways to overcome them.

Keywords: international financial reporting, the income statement, international financial reporting standards, business, investment.

An important component of manager-owner communication is the firm's financial statements. Firms organized as proprietorships or partnerships are not required to prepare financial reports or statements except for tax purposes. Of course, proprietors and partners must gather financial data so as to be able to evaluate their financial performance over time. Requests for bank loans need to be accompanied by recent financial statements, too. In contrast, companies organized as corporations are required to prepare financial reports annually for the benefit of their shareholders. Public corporations are required to fi le annual reports with the SEC. An annual report contains descriptive information on operating and financial performance during the past year, a discussion of current and future business opportunities, and financial statements that provide a numerical record of financial performance. Usually, financial highlights are provided on the first page or two, followed by a letter to the stockholders by the fi rm's chairman of the board and chief executive officer (CEO). The CEO summarizes the financial results for the year and identifies the firm's strengths, such as employee talents and the size of its customer base. After the CEO's letter, most companies describe their current business areas, future opportunities, and financial goals, such as a target return on equity or earnings growth rate.

The income statement reports the revenues generated and expenses incurred by a firm over an accounting period, such as a quarter or year. The accrual concept is used to construct the income statement. Let's look at some of the major income statement accounts in greater detail. The starting point of the income statement reflects the revenues or sales generated from the operations of the business. Often, gross revenues are larger than net revenues. This is due to sales returns and allowances that may occur over the time period reflected in the income statement.





In addition to the income statement and balance sheet, corporate annual reports also want to measure changes in cash flows. All three of the previously described financial statements are prepared using an accrual accounting system whereby items are recorded as incurred but not necessarily when cash is received or disbursed. For example, a sale of \$100 is recorded as a sale this year even though the cash is not expected to be collected until next year.

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