Financial Statements 101

A **Profit and Loss (P&L) Statement**, **Balance Sheet**, and **Cash Flow Statement** are like three essential report cards for a business. They each tell a different part of the story about a company's financial health, and together, they provide a complete picture.

Profit and Loss (P&L) statement

What it is: An accounting of a company's financial performance over a specific period, such as a quarter or a year. It shows the money the company earned (revenue) and the money it spent (expenses). The "bottom line" shows whether the company made a profit or took a loss.

- **Simple analogy:** This is like a report card showing your total income from your job versus your total spending over a month.

  ### Used for:

  - **Assessing profitability:** To see if the business is actually making money.
  - **Identifying trends:** To spot whether revenue is growing or expenses are increasing over time by comparing different periods.
  - **Making decisions:** To identify where costs can be cut or which products are most profitable.

Balance sheet

What it is: A snapshot of a company's financial position at a single, specific point in time, like the last day of the year. It follows the basic equation: **Assets = Liabilities + Owner's Equity**.

- **Assets:** What the company owns, such as cash, equipment, and buildings.
- **Liabilities:** What the company owes to others, such as loans and bills.
- **Owner's Equity:** The amount of money invested in the business by its owners, plus any profits that have been kept.
- **Simple analogy:** This is like a photo of your financial situation today. It lists everything you own (assets), everything you owe (liabilities), and what's left over for you (net worth).

  ### Used for:

  - **Determining net worth:** To calculate the company's overall financial value.

- **Checking financial health:** To see if the company has enough assets to cover its debts.
- **Attracting lenders and investors:** To show external parties the company's financial strength.

Cash flow statement

What it is: A report that tracks the actual cash moving in and out of a business over a period of time. Unlike a P&L, which might include money that is earned but not yet collected, the cash flow statement focuses purely on cash transactions.

- **Simple analogy:** This is like looking at your bank account statement, showing every deposit and withdrawal. You can be profitable on paper but still do not have enough cash in the bank to pay your bills.

  ### Used for:

  - **Managing liquidity:** To ensure the business has enough cash on hand to pay its bills.
  - **Understanding cash generation:** To see where the company's cash is coming from: operations, investments, or financing.
  - **Predicting future cash needs:** To forecast potential shortfalls and plan for the future.

How they work together

These three statements are interconnected and are most useful when analyzed together.

- The **P&L** shows you if your business is profitable.
- The **Balance Sheet** gives you a snapshot of what you own and owe at a specific time.
- The **Cash Flow Statement** tells you if you have enough actual cash to keep the business running.

For example, a business might look very profitable on its P&L, but its cash flow statement could reveal that it's running out of cash because customers are not paying their bills on time. A glance at the Balance Sheet would then show an increase in what's owed to the company (accounts receivable).