**VIDEO SERIES: FAST FINANCE**

**No. 12: LINKING INCOME STATEMENTS & BALANCE SHEETS**

**Linking Income Statements and Balance Sheets**

Understanding how income statements and balance sheets link is fundamental when analyzing financial statements. Economic events effect a company’s income statement and balance sheet simultaneously. Assessing economic events from both income statement and balance sheet perspectives will help a reporter develop insights about a company’s financial performance.

The income statement measures net income (NI) as earnings realized over an accounting period. NI is then added to retained earnings. Retained earnings is the money a company realized in an earlier accounting period and reinvested in its core business, rather than paid to shareholders as dividends. Add NI and retained earnings to come up with the shareholders’ equity on the balance sheet.

**The simple equation**

Since the balance sheet equation is assets equals liabilities plus shareholders’ equity, or A = L + SE, if NI and SE increase, so must A – L because A – L = SE.

Suppose NI is $10. Then SE increases by $10 as well, and A – L increases by $10. An investor can analyze why NI increased on the balance sheet by $10 by evaluating various revenue, gain, expense and loss accounts on the income statement. Exploring both the balance sheet and income statement often generates a better understanding of economic events causing the $10 NI increase.