

### 3 Statement Linking

#### Breakdown of how the three core financial statements is linked, highlighting the key points:

##### 1. Income Statement to Balance Sheet

- **Net Income:**
  - **Key Point:** Net Income from the Income Statement is the primary link.
  - **Connection:** Net income flows into the equity section of the Balance Sheet as part of **Retained Earnings**.
  - **Impact:** If a company earns a profit, retained earnings increase; if it incurs a loss, retained earnings decrease.
- **Depreciation & Amortization:**
  - **Key Point:** These are non-cash expenses recorded on the Income Statement.
  - **Connection:** They reduce the value of **Fixed Assets** on the Balance Sheet (e.g., Property, Plant & Equipment).
  - **Impact:** This reduction represents the wear and tear or usage of long-term assets over time.
- **Interest Expense:**
  - **Key Point:** Interest expense affects both the Income Statement and the Balance Sheet.
  - **Connection:** Interest expense is recorded on the Income Statement, and the corresponding interest payable is recorded as a **Liability** on the Balance Sheet.
  - **Impact:** Interest payments reduce net income, impacting retained earnings and increasing liabilities.
- **Dividends:**
  - **Key Point:** Dividends are distributions to shareholders.
  - **Connection:** Dividends declared reduce **Retained Earnings** on the Balance Sheet.
  - **Impact:** While dividends do not appear on the Income Statement, they reduce equity on the Balance Sheet.

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##### 2. Balance Sheet to Cash Flow Statement

- **Operating Activities:**
  - **Key Point:** The changes in working capital items are critical here.
  - **Connection:** **Current Assets** (like Accounts Receivable, Inventory) and **Current Liabilities** (like Accounts Payable) on the Balance Sheet impact the **Cash Flow from Operating Activities**.

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- **Impact:** An increase in Accounts Receivable decreases cash flow; an increase in Accounts Payable increases cash flow.
  - **Investing Activities:**
    - **Key Point:** This section deals with changes in long-term assets.
    - **Connection:** Purchases or sales of **Long-Term Assets** (like property or equipment) on the Balance Sheet are reflected in the **Investing Activities** section of the Cash Flow Statement.
    - **Impact:** Capital expenditures decrease cash flow; proceeds from the sale of assets increase cash flow.
  - **Financing Activities:**
    - **Key Point:** This involves changes in debt and equity.
    - **Connection:** **Long-Term Liabilities** (like loans) and **Equity** (like issuing shares) on the Balance Sheet affect the **Financing Activities** section of the Cash Flow Statement.
    - **Impact:** Borrowing funds increases cash flow; repaying loans or paying dividends decreases cash flow.
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### 3. Cash Flow Statement to Balance Sheet

- **Ending Cash Balance:**
  - **Key Point:** This is the final result of the Cash Flow Statement.
  - **Connection:** The **Ending Cash Balance** from the Cash Flow Statement becomes the **Cash** line item on the Balance Sheet.
  - **Impact:** This balance represents the company's liquidity at the end of the period.
- **Net Income:**
  - **Key Point:** Net income is the starting point for cash flow from operations.
  - **Connection:** It begins with net income from the Income Statement and adjusts for non-cash items (like depreciation) and changes in working capital.
  - **Impact:** This adjustment shows the cash-generating capability of the company's operations.
- **Depreciation:**
  - **Key Point:** This is a non-cash expense.
  - **Connection:** Depreciation is added back to net income on the Cash Flow Statement since it doesn't affect cash, even though it reduces the book value of assets on the Balance Sheet.
  - **Impact:** It helps reconcile the non-cash impact on the Income Statement with the cash movements shown on the Cash Flow Statement.

### Summary of the Flow:

#### 1. Income Statement:

- **Key Link:** Net Income → **Retained Earnings** (Balance Sheet) & **Starting Point** for Cash Flow from Operations (Cash Flow Statement).

#### 2. Balance Sheet:

- **Key Link:** Changes in Assets/Liabilities → **Operating, Investing, Financing Activities** (Cash Flow Statement).
- **Key Link:** Cash Balance → **Ending Cash** on Balance Sheet.

#### 3. Cash Flow Statement:

- **Key Link:** Ending Cash Balance → **Cash** (Balance Sheet).
- **Key Link:** Non-cash expenses like Depreciation → **Adjustments** in Cash Flow.