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INFORMATION FROM THE INCOME STATEMENT IN FUNCTION OF THE BANK MANAGEMENT

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Abstract

At the very beginning, it is good to make a distinction regarding the use of the term "Income statement" used in the Macedonian practice, and it can also be found under the name "Profit and loss statement" i.e."Profit Statement". Regardless of the terminology, it can be concluded that this financial report shows the success or the failure from the operation of an enterprise, i.e. it is a report that evaluates the success of the operation of theenterprisein a period of one calendar year. The management, the employees and the investors use this report according to their subjective analysis i.e. to determine the profitability, the investment value and the creditworthiness of the particular enterprise.

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Introduction

The Income Statement provides the managers and the other users of the financial reports with information that help them to predict the amounts, the duration and uncertainty of the cash flows in the enterprise. Unlike the Balance sheet which is prepared and refers to a specific time (date) and provides the users with information about the assets, the liabilities and the equity; The Income Statement provides the users with information aboutthe ***incomes and expenditures*** over a period of time in the enterprise.

Income reports

The management in the enterprise prepares this balance sheet in order to determine the financial result as a **profit** for distribution when:

TOTAL INCOMES> TOTAL EXPENDITURES + TAX INCOME

If the management in the enterprise determines a financial result as a **loss**, then:

TOTAL EXPENDITURES + TAX INCOME> TOTAL INCOMES

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In relation to this, it can be concluded that the information from the Income Statement in today's modern trends of the economic activity are of a crucial importance i.e. in the function of making managerial decisions important for the continuous economic development of the enterprise itself. Actually, that information follow the appearance of transactions recorded as income positions, i.e.positions of the expenditures and contribute to the success of the financial operations, and hence for the overall operation of the enterprise.

Benefits and limitations of the information from the Income Statement

By noticing the information from the profit report or if you prefer the Income Statement, customers will be able to predict future cash flows. It is obvious that his use of the Income Statement is important, but in practice there are many ways in which information helps their users.

Firstly, the investors and the creditors use the information from the Income Statement to ***assess the performance of the enterprise***, i.e.***to assess its past success (its performance)***. This means that the success in the past is not always a success for the future, but at least some future directions (trends) are identified by explaining how to recognize the future economic trends. In fact, such information from the Income Statement serves to try to establish the correlation between past and future success, just right now, when we need to accumulate confidence in the predictions of future economic flows. As much as the correlation between past and future success is safer, the less confidence the users will have when predictingthe future economic flows.

Secondly, the Income Statement helps the users to make a ***preliminary risk assessment*** (the maximum level of uncertainty) ***of failure to achieve certain cash flows***, giving information about different components such as profit - income / expenditures, i.e. profit - loss . With such information we can, for example, more precisely assess the effect of a change in the demand for the company's product upon theincomes and the expenditures i.e.the effect ofthe profits in the balance sheet.

In addition to this, through the Income statement, **diversification of the success in the operation** is performed. This means a diversification of the operational performance from other aspects of operation that can provide useful knowledge in business decision-making. Because the activities are the main assets that further generate income and cash, the results of the regular continuous activities undoubtedly have much greater significance than the results of the unforgettable activities and events.

Sometimes, we can ask ourselves the following question: *Can "the continuous operations (the results of continuous activities)" have the same impact i.e. the same as "unrepeatable activities" and thus cheat the investors?*

In relation to this, we take the case of the **National Patent Dvelopment**, a specialized company for production of soft contact lenses in the United States. First of all, it reported profit from *continuous pre-taxation activities* of $ 18.6 million, but with a more comprehensive and full examination of this profit, it was found that:

(1) $ 7.5 million of the profit originate from earnings by selling subsidiary shares;

(2) $ 2.4 million areprofit from stock swaps;

(3) 3.6 million dollars originate from the sale of shares from its own investment portfolio; and

(4) $ 3.2 million originate in lawsuits involving patent infringement;

The largest source of income for the National Patent Dvelopment (*$ 9.9 million from the sale of their soft contact lenses*) could not continue to be achieved due to the fact that the company's patent law for this process was in the phase of leakage (extinction). This means that the aforementioned realized incomes in items (1), (2), (3) and (4) collectively added give a total income of $ 16.7 million, which deducted from $ 18.6 million (*profit from continuous pre-tax activities*) gives the figure of $ 1.9 million, which in this case arerealized incomes from operating activities, i.e. from the sale of soft contact lenses. This shows that we have a drastic reduction in sales incomes from the regular activities of the company Nacional Patent Dvelopment, ranging from $ 9.9 to $ 1.9 million, which confirms the previously established claims for the expiration of the patent right. Such a situation in the company is bad signal for the potential investors, who seemingly without a pre-in-depth analysis of the position - profit ($ 18.6 million), maybe they would invest, but that's how this possibility is reduced.

Our point here is the following:

- to show that the profit made on the last line of the Income Statement does not explain the whole story. Therefore, one of the benefits of the Income Statement is the **diversification of the operational success**, which means diversifying of the operational success from the other aspects of the operation.

In theory and practice, it often comes to opposing certain attitudes, i.e. many economists criticize the accountants for defining the profit because the accountants do not include many items that contribute to the general growth and well-being of the enterprise.

When talking about this, we have the research of the economist Hicks JR[†]. who defined the **profit** as:

> "the maximum value an entity can spend over the period and still be rich at the end as it was at the beginning."

(Hicks J.R. (1946), p.172)

As analysts, any effort they would make to assess the entity's wealth at any time will prove to be impartial, unless reliable restrictive assumptions are applied and developed. In this context, as students of master studies we can ask ourselves the following question:

- *How much was our net profit last year?*

Suppose we worked in the summer and we earned 45,000 denars. Because we pay taxes, tuition and other living expenses, our profit report may show a loss for the year if it is measured in terms of rightdenar value. Actually, the research does not state, to put the focus of our interest on the following two questions:

- *Can we bear the loss?*
- *What is the satisfaction of the acquired knowledge of the master studies during this year?*

In the context of this, we can interpret the Hicks definition saying that you should not measure profits only in money, but also the **well-offness**, defined as a *measure of growth in the net wealth caused by qualitativefactors* - in our case, the value of our acquired knowledge of master's studies.

Starting from the fact on the different interpretation of the profits, the critics of the economists can be justified in relation to the defining the profit by the accountants. After all, accountants know that the diversification of the profit (the well offness) and the recognition of such experiences can be very useful, but the problem of measuring the profit is not solved. This implies that the positions in the Income Statement that can not be quantified with some degree of reality (the position - spiritual gain) should be *rejected* while determining the profit.

Accordingly, it **can not be said** that the total amount of the profit is uniformly and precisely defined, because the profit data is often obtained under the strong influence of the applied accounting methods. But it **can** be said that the **quality of the profit** for a given enterprise is of particular importance. Companies that use liberal - aggressive (without strong influence of accounting methods) accounting policies, announce higher profit numbers on a

[†]Hicks J.R. (1946), Value and Capital, clarendon Press: Oxford, page172

short term. In such cases we say that the quality of the profit is low. Other companies generate profits as a result of non-operating and unrepeatable events, but such profit can not be sustained over a longer period of time. That is why it is necessary, the importance of the quality of the profit to be reviewed in the following **example**:

The joint stock company "XY" for 2006 announced earnings per share of 4.77 €, which compared to last year (where there is a profit of 3.99 € per share) represents approximately an increase of 20%. At first glance, an increase of 20% can be a good effect on the quality of earnings, but if we make a comprehensive analysis of profits we may not be "happy" about the quality of such growth. In fact, the analysis of the quality of the profits gives the following results:

- € 2.20 per share - earned from the sale of operational business lines;
- € 0.17 per share - derived from the tax exemption from the state for encouraging export activities;
- 0.19 € per share - further arise from the complicated unrelated exchange of the company's preferential shares.

From this we ask ourselves:

- *How realistic is the increase of 20% of the enterprise, i.e. How sustainable is the announced price of € 4.77 per share?*

We get the answer to this question when the additional parts of the earnings per share will be deducted from the total sum of earnings (€ 4.77), whereby we get:

4.77 - (2.20 + 0.17 + 0.19) = **2.21 € per share.**

The profit of 2.21 € per share, is a ***real accomplishment from continuing activities in the company***. In this way, we get the answer to our previously contaminated question, that the earnings for 2006 is not sustainable and the real reported profit of 2.09 € *per share*should not surprise us for the next year of the Joint Stock Company "XY", which is a decrease in the earnings by 56%.

Concluding observations

The conclusion is clear:**"if there would not be diversification of profits, then the management, the employees, investors, creditors and the other F / I users will not be able to see the" *true origin of the profit* ", i.e. whether the performance of the enterprise is based on real profit from ongoing activities or on a successful management of its own portfolio in the long-term securities market (stock exchange)".**

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