Introduction

This chapter is all about measuring performance and, in particular, about income-statement measures, which are used to assess companies' financial performances during reporting periods.

You already know a great deal about assessing performance: you and others have been assessing how well you've been doing since you were a child. Undoubtably, you've measured your own performance in various dimensions of your life including school, sports, work, and social interactions. You also know measuring performance reliably can be challenging. For example, exam scores do not always reflect what you've learned.

How do income statements and balance sheets differ? Balance sheets report, albeit imperfectly, a company's assets, liabilities, and owners' equity at a point in time. In doing so, they reflect (among other things) the net effects of the company's performance from the time it was founded until the balance-sheet's reporting date. By contrast, income statements measure performance over short intervals of time such as quarters or years. For example, Intel's 2010 *income statement* reports its financial performance *during* 2010, but its 2010 *balance sheet* measures it *cumulative performance* since the company was founded in 1968.

An analogy to grades might help here. Your cumulative grade point average (GPA) is like a balance sheet measure — it reflects your cumulative academic performance, although imperfectly, since you started college. By contrast, your GPA for a specific term is like an income statement measure — it reflects your performance during that term only.

In predicting your future performance, prospective employers would likely assess your cumulative GPA and trends in your GPAs for each term. For example, they might view a 2.50 cumulative GPA more favorably if you earned a 4.00 during your senior year while taking demanding courses than if you earned a 2.50 each year. The average is the same, but the trend provides additional insight. Similarly, in predicting companies' future performance, among many other things, investors assess the extent to which trends in past income-statement measures will likely persist in the future.

One of the most important lessons of this chapter is that income-statement measures are based on changes in balance-sheet measures. This means concerns you might have about the fuzziness of a company's balance sheet, because items are missing or difficult to measure reliably, transfer to its income statements.

Also similar to balance sheets, your capacity to assess the usefulness of income-statement numbers for your decisions depends on the extent to which you understand the events, circumstances, and accounting decisions behind them. This chapter will help you develop a foundation for these assessments.

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