



VARZA SCHOOL · THE FOUNDATIONAL 100

One Business, Four Statements: Connections, Ratios, and the Complete Financial Story

Chapter 38 · Track 4 — Money Accounts, Financial Statements, and Trustworthy Records

THE QUESTION IT ANSWERS

How do the statement of financial position, profit or loss, cash flows, and changes in equity describe one business from different but reconciling perspectives?

CONCEPTS DEFINED

Statement of financial position · Statement of profit or loss · Statement of cash flows · Statement of changes in equity · Financial ratio · Profit · Cash flow · Equity

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Varza promise: clear enough for a first-time learner, exact enough for a professional conversation, and practical enough to support a real decision.

Why this chapter matters

This track turns records into statements and trust. It connects cash locations, currency, timing, measurement, reconciliation, closing, and control so that reports describe one coherent financial reality rather than separate piles of numbers.

Central question: How do the statement of financial position, profit or loss, cash flows, and changes in equity describe one business from different but reconciling perspectives?

No primary statement is complete alone. Profit changes equity, cash flow explains cash, owner transactions alter equity and financing, and closing balances carry the accumulated effects. Connections and ratios reveal consistency, but interpretation requires notes, definitions, and operational evidence.

Varza approaches the subject from life to ledger and from ledger to decision. We begin with what actually happened, identify the rights, obligations, resources, timing, and uncertainty, and only then choose the correct term, calculation, document, or account. This order protects the learner from a common error: learning a label without understanding the economic reality that the label is supposed to describe.

Learning outcomes

- Define and distinguish statement of financial position in plain and professional language.
- Define and distinguish statement of profit or loss in plain and professional language.
- Define and distinguish statement of cash flows in plain and professional language.
- Define and distinguish statement of changes in equity in plain and professional language.
- Apply the concepts to a numerical case and explain the result rather than only calculate it.
- Identify evidence, workflow, controls, and Varza entities required for reliable use.
- Recognize when jurisdiction-specific or licensed professional advice is required.

The Varza mental model

A financial concept becomes decision-ready when six questions have answers: **what, who, when, how much, based on what evidence**, and **under which assumption or rule**. A seventh question—**what should happen next**—turns knowledge into management.

This chapter uses internationally recognized terminology, but it remains jurisdiction-neutral unless explicitly stated. Accounting standards, tax rules, contract law, consumer protection, labor

requirements, and investment regulation can produce different legal outcomes in different countries. The global foundation gives the learner a stable map; local collections must add the binding rules.

Core concepts

1. Statement of financial position

Working definition. Statement of financial position is a financial statement presenting recognized assets, liabilities, and equity at a specified date.

It is a structured snapshot, not a valuation of the whole business. Unrecognized capabilities, current market values, and future opportunities may not appear. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. Cash, receivables, inventory, equipment, payables, loans, and equity are presented by classification.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

2. Statement of profit or loss

Working definition. Statement of profit or loss is a financial statement presenting recognized income and expenses for a period and the resulting profit or loss.

Read it with the balance sheet, cash flows, policies, and notes. Profit can be influenced by timing, estimates, classification, and non-cash items. The concept should be measured at the smallest level that still supports a real action.

Simple example. Revenue less cost of sales and operating expenses produces operating performance before financing and tax categories.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

3. Statement of cash flows

Working definition. Statement of cash flows is a financial statement explaining changes in cash and cash equivalents through operating, investing, and financing activities.

It reconnects accrual performance with liquidity movements and reveals how operations, assets, and financing consumed or generated cash. The number alone is not enough; its definition determines whether comparisons are valid.

Simple example. Customer collections are operating inflows while equipment purchases are investing outflows.

Decision test. What is being measured, and what has been left outside the boundary? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

4. Statement of changes in equity

Working definition. Statement of changes in equity is a financial statement reconciling each component of equity from opening to closing balance.

It separates owner contributions, distributions, period result, and other recognized changes. This is where operational activity and financial reporting meet.

Simple example. Opening retained earnings plus profit less dividends equals closing retained earnings, subject to other adjustments.

Decision test. When did the underlying right, obligation, benefit, or sacrifice arise? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

5. Financial ratio

Working definition. Financial ratio is a relationship between two or more financial amounts used to examine liquidity, profitability, efficiency, leverage, coverage, or market characteristics.

Ratios compress information and require consistent definitions, comparable periods, context, and investigation of the underlying amounts. In Varza language, the concept becomes useful when it changes a decision.

Simple example. Current assets divided by current liabilities is one liquidity indicator, not a complete liquidity conclusion.

Decision test. Which document or observation would allow another person to verify it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

6. Profit

Working definition. Profit is the residual increase in equity from recognized income after recognized expenses for a period, excluding owner transactions.

Profit is an accounting measure of performance, not a bank balance. Its quality depends on measurement, timing, estimates, and whether it converts into cash. The professional term matters because it prevents two different realities from being recorded as though they were the same.

Simple example. A credit sale can increase profit before the customer pays, while buying equipment can reduce cash without creating an immediate equal expense.

Decision test. How would a different assumption change the result? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

7. Cash flow

Working definition. Cash flow is the movement of cash and cash equivalents into and out of a person, project, or organization.

Profit measures performance under accounting rules; cash flow measures liquidity movement. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. Collecting an old invoice creates cash inflow without creating current-period revenue.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

8. Equity

Working definition. Equity is the residual interest in assets after liabilities are deducted.

Equity is not identical to cash. It represents the owners' residual claim and changes with contributions, withdrawals, profit, and loss. The concept should be measured at the smallest level that still supports a real action.

Simple example. If assets are CU 200,000 and liabilities are CU 125,000, equity is CU 75,000.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

How the concepts connect

The concepts in this chapter are a system, not a vocabulary list. Statement of financial position, Statement of profit or loss, Statement of cash flows, Statement of changes in equity, Financial ratio, Profit, Cash flow, and Equity describe different parts of the same decision. Confusing them usually creates one of three failures: the wrong amount is measured, the right amount is assigned to the wrong period or person, or a correct report is used for a decision it was never designed to support.

A useful analysis therefore preserves both **classification** and **relationship**. Classification tells us what an item is. Relationship tells us what caused it, what it affects, and what could change it. Varza should store both. A report that shows only totals may be suitable for orientation; a controlled decision requires traceability to the underlying relationships.

Formulas and quantitative relationships

Return on assets

$$ROA = \text{Defined profit} \div \text{Average total assets}$$

The ratio relates period performance to resources employed.

Boundary: Specify profit measure, average period, asset measurement, and industry context.

Asset turnover

Asset turnover = Revenue ÷ Average total assets

The ratio describes revenue generated per unit of recorded assets.

Boundary: It does not measure margin, cash, unrecognized assets, or asset quality.

DuPont-style relation

ROA ≈ Profit margin × Asset turnover

Using consistent definitions, profitability and resource use combine to explain return on assets.

Boundary: Rounding and selected profit definitions affect equality.

Worked case — The four-statement narrative

A company starts with CU 500,000 equity, earns CU 80,000, buys CU 120,000 equipment for cash, borrows CU 70,000, and distributes CU 20,000.

Item	Amount or observation
Income statement	CU 80,000 profit
Equity statement	+80,000 profit –20,000 distribution
Cash-flow statement	operating effects plus –120,000 investing +70,000 financing –20,000 distribution
Balance sheet	equipment, loan, cash, and closing equity reflect all events
Closing equity	CU 560,000 before other changes

Calculation and reasoning

1. Profit adds CU 80,000 to equity; equipment purchase does not create equal immediate expense.
2. Borrowing increases cash and liability, not profit.
3. Distribution reduces cash and equity, not operating expense.
4. The cash-flow statement explains why cash may fall despite profit.
5. The closing balance sheet must contain the remaining equipment, loan, cash, and CU 560,000 equity.

What the result means

The statements are four views of one event system. Apparent contradictions usually become understandable when financing, investment, working capital, and non-cash recognition are

connected.

The case is deliberately compact. In practice, Varza would preserve the supporting documents, currency, dates, counterparty, project or cost center, approvals, and links to the resulting records. The lesson is not merely to reach a number; it is to make the path to that number reviewable.

Practical workflow

1. **Define the decision, responsible person, economic unit, period, and acceptable uncertainty.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
2. **Verify that statement totals connect to the same approved ledger and period.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
3. **Trace profit to equity movement and cash change to the cash-flow statement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
4. **Calculate a small set of defined ratios and compare trends.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
5. **Investigate apparent contradictions through working capital, non-cash items, financing, estimates, and notes.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
6. **Reconcile the result to source evidence and investigate exceptions rather than forcing agreement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
7. **Approve the decision or record at the authority level required by value, risk, and legal consequence.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
8. **Monitor the outcome, compare it with the original assumption, and retain the learning for the next cycle.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.

How this concept should appear in Varza

The minimum Varza data model for this chapter includes `financial_statement_set`, `comparative_period`, `note`, `cross_statement_link`, `ratio`, `reconciliation`, `management_analysis`, `source_schedule`. These names are not merely interface labels. Each entity should have a stable identifier, status history, responsible owner, applicable currency or unit, effective dates, evidence links, and access controls.

A useful Varza screen should answer four questions without forcing the user to reconstruct the story manually:

1. **What happened or is expected to happen?** Show the operational event, obligation, or decision in plain language.
2. **What changed financially?** Show cash, asset, liability, equity, income, expense, commitment, or risk effects.
3. **Why should the user trust it?** Show source documents, calculations, approvals, and revision history.
4. **What requires attention now?** Show exceptions, due dates, thresholds, and the next responsible action.

The Varza design principles most relevant here are:

- Attach every important number to a source, period, currency, entity, and responsible person.
- Prefer a traceable estimate with stated assumptions to an impressive number with hidden assumptions.
- Use automation to strengthen evidence and consistency, never to remove accountability.

Varza AI may explain, classify, compare, simulate, and prepare a proposed action. It should not silently change a legal record, post a material transaction, close a period, release a payment, or make an investment decision on the user's behalf. Material actions require visible evidence, permissions, validation rules, and an accountable human approval path.

Controls and professional boundaries

1. **Automated cross-statement consistency tests.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
2. **Ratio definition registry.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
3. **Management commentary tied to evidence and reconciled measures.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
4. **Stable definitions, versioned assumptions, and consistent units across plans, records, and reports.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
5. **Traceability from every material total to evidence, calculation, owner, and change history.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
6. **Access and approval rights aligned with responsibility and the possible consequence of error or misuse.** The control should be proportionate to value and risk, documented clearly, and tested

often enough to detect failure before the consequence becomes irreversible.

A control is effective only when it operates in practice. A policy that everyone can bypass is a statement of hope, not a control. Likewise, a control that blocks ordinary work without distinguishing low-risk and high-risk cases encourages hidden workarounds.

Common mistakes and better responses

Mistake 1: Reading only profit and ignoring balance-sheet risk

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 2: Reading only bank cash and ignoring unpaid obligations

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 3: Comparing ratios with different denominators or policies

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 4: Using a favorable average that hides a deteriorating segment or month

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 5: Using a technically correct number outside the period, entity, currency, or decision boundary for which it was calculated

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 6: Accepting an automated result without reviewing the evidence, assumptions, exceptions, and required professional judgment

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Decision checklist

- ☐ Can I explain statement of financial position in plain language and in professional terms?
- ☐ Can I explain statement of profit or loss in plain language and in professional terms?
- ☐ Can I explain statement of cash flows in plain language and in professional terms?
- ☐ Can I explain statement of changes in equity in plain language and in professional terms?
- ☐ Have I stated the entity, currency or unit, date or period, and decision boundary?
- ☐ Can another person reproduce the number from retained evidence?
- ☐ Have I separated actuals, estimates, commitments, and scenarios?
- ☐ Have I tested timing, liquidity, risk, and at least one adverse outcome?
- ☐ Is the required approval proportional to the possible loss or legal consequence?
- ☐ Does the final output lead to a specific action, owner, and review date?

Practice lab

1. **Explain it.** Describe Statement of financial position to a person who has never studied finance. Then add the professional definition and identify one boundary your simple explanation omitted.
2. **Classify it.** Create five examples from your household or a small business and classify each using Statement of profit or loss. State any assumptions.
3. **Calculate it.** Rebuild the worked case with amounts 20% higher. Identify which conclusions change and which remain structurally true.
4. **Challenge it.** Describe a situation in which Statement of cash flows could be measured correctly but still lead to a poor decision because timing, risk, or incentives were ignored.
5. **Design it.** Sketch a Varza screen or report for this chapter. Include fields, evidence links, status, owner, exceptions, and one AI-assisted action.

Answer guidance

A strong answer uses consistent definitions, reveals assumptions, distinguishes fact from estimate, and connects the result to an action. More than one conclusion may be reasonable when the learner clearly states the decision objective and uncertainty. The worked-case recalculation should preserve the method even when the numbers change.

Varza AI knowledge capsule

This capsule is intentionally explicit so that a retrieval system can distinguish canonical teaching points from examples and commentary.

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    "Statement of changes in equity: a financial statement reconciling each component of equity from opening to closing balance.",
    "Financial ratio: a relationship between two or more financial amounts used to examine liquidity, profitability, efficiency, leverage, coverage, or market characteristics.",
    "Profit: the residual increase in equity from recognized income after recognized expenses for a period, excluding owner transactions.",
    "Cash flow: the movement of cash and cash equivalents into and out of a person, project, or organization.",
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Suggested questions for Varza AI

- Explain this chapter using an example from a household, a shop, and a service business.
- Ask me five diagnostic questions before applying this concept to my situation.
- Show the difference between cash effect, accounting effect, and decision effect.
- Recalculate the worked case using my currency and assumptions, but preserve the original definitions.
- Identify which parts require local accounting, tax, legal, labor, or investment rules.

Sources and standards horizon

This chapter is original Varza educational content. It paraphrases and synthesizes concepts; it does not reproduce a standard or third-party article. The following sources were used to establish terminology, scope, and current professional context:

- **S021 — U.S. Securities and Exchange Commission, *Beginners' Guide to Financial Statements*.** accessed 2026-08-31. Four primary financial statements and their purposes. Source: <https://www.sec.gov/about/reports-publications/investorpubsbegfinstmtguide>
- **S101 — IFRS Foundation, *Conceptual Framework for Financial Reporting*.** 2018; accessed 2026-08-31. Objectives, qualitative characteristics and elements of financial reporting. Source: <https://www.ifrs.org/issued-standards/list-of-standards/conceptual-framework/>
- **S103 — IFRS Foundation, *IAS 7 Statement of Cash Flows*.** 2026 standards set. Operating, investing and financing cash-flow presentation. Source: <https://www.ifrs.org/issued-standards/list-of-standards/ias-7-statement-of-cash-flows/>
- **S116 — IFRS Foundation, *IFRS 18 Presentation and Disclosure in Financial Statements*.** issued 2024; effective 2027. Future presentation and disclosure requirements replacing IAS 1 from 2027. Source: <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-18-presentation-and-disclosure-in-financial-statements/>
- **S117 — IFRS Foundation, *IFRS for SMEs Accounting Standard*.** third edition 2025; effective 2027. Simplified global reporting framework for eligible small and medium-sized entities. Source: <https://www.ifrs.org/issued-standards/ifrs-for-smes/>

Standards horizon. Reviewed through 2026-08-31. IFRS 18 and the third edition of the IFRS for SMEs Accounting Standard are included as transition knowledge where relevant; both have mandatory effective dates beginning in 2027, with early application permitted under their respective requirements.

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