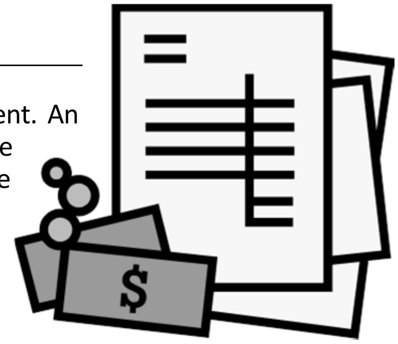
Income Statement



One of the most important documents for a business is an income statement. An income statement is a financial document that summarizes a business's income and expenses over a given time period and shows whether the business made a profit or took a loss. That's why it's also called a profit and loss statement. If a business's sales are greater than its expenses, the income statement will show a profit. If a business's sales are less than its expenses, the income statement will show a negative number, a loss.

When to Prepare an Income Statement
Because income statements show how a business is performing, they are prepared periodically. Most small-business owners should create a monthly income statement. Most companies also prepare income statements on an annual basis that show how the company performed during the year.

Differences in Income Statements
Income statements can vary in wording, but they all include the same basic information: revenue, expenses, and net income or loss. However, a significant difference in income statements is how businesses show their variable expenses. Based on the type of business, variable expenses will appear under these headings:

- Cost of Goods Sold. Merchandising businesses (wholesale and retail companies) keep track of the cost of their beginning inventory, the cost of any additional inventory they purchase, and the cost of their ending inventory. This allows them to calculate the cost of inventory sold during this period.
- Cost of Goods Manufactured and Sold. Manufacturing companies track the cost of both labor and materials. The two are added to arrive at the cost of the products they are selling.
- Cost of Services Sold. Service companies track materials involved in providing their services. Sometimes they include the cost of labor if the service can be easily broken down into segments.

MERCHANDISIING BUSINESS: Matt's Hats
Income Statement for Month Ended August 31, 20--

Matt Washington has a summertime business. He sells hats on the boardwalk near the beach. He stores his hats in a large locker he rents from a local merchant. He runs the business from his parents' home and makes a contribution toward their utilities. Matt needs to prepare an income statement for August. Because he has a retail business (selling hats purchased from a wholesaler), Matt uses Cost of Goods Sold to categorize his variable expenses. Below is a sample income statement for Matt's Hats and illustrates the six parts of a typical income statement. If you have a merchandising business (wholesaling or retailing), your income statement will be similar to Matt's.

REVENUE			
Gross Sales	$ 4,800		
Sales Returns	400		
Net Sales			$ 4,400
COST OF GOODS SOLD			
Beginning Inventory	$ 1,200		
Add: Purchases	600		
Total		$ 1,800	
Less: Inventory, August 31		480	
Cost of Goods Sold			1,320
GROSS PROFIT			**$ 3,080**
OPERATING EXPENSES			
Advertising	$ 100		
Insurance	200		
Rent	150		
Telephone	100		
Utilities	100		
Total Expenses			650
PRE-TAX PROFIT			**$ 2,430**
Taxes (15%)			365
NET PROFIT			**$ 2,065**

Questions for Discussion

1. What are main differences between income statements for merchandising businesses, manufacturing businesses, and service businesses?

2. Name the six parts of a typical income statement.

3. You have a business selling snapbacks to friends and classmates. This June you bought 20 snapbacks for $5 each and sold them all at $10 each. You paid $40 in commissions to your brother to help you sell them, and you spent $20 on posters as advertising. Your taxes are 20% of your pre-tax profit. Prepare your income statement.

Income Statement for Month Ended ___________________

REVENUE			
Net Sales		$__________	*Multiply the number of snapbacks sold by the price you <u>sold</u> them for ($10 x 20)*
COST OF GOODS SOLD			
Cost of Goods Sold		$__________	*Multiply the number of snapbacks sold by the price you <u>paid</u> for them ($5 x 20)*
GROSS PROFIT		$__________	*Net Sales minus COGS*
OPERATING EXPENSES			
Advertising	$__________		
Commissions	$__________		
Total Expenses		$__________	
PRE-TAX PROFIT		$__________	*Gross Profit minus Total Expenses*
Taxes (20%)		$__________	*Pre-Tax Profit times 0.20*
NET PROFIT		$__________	*Pre-Tax Profit minus Taxes*