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INCOME STATEMENT

The income statement is one of the three important financial statements used for reporting a company's financial performance over a set accounting period. The other two key statements are the balance sheet and the cash flow statement.

An income statement is a financial report used by a business. It tracks the company's revenue, expenses, gains, and losses during a set period. Also known as the **profit and loss (P&L) statement** or **the statement of revenue and expense**, it provides valuable insights into a company's operations, the efficiency of its management, underperforming sectors, and its performance relative to industry peers.

Example of an Income Statement

Example Corporation
Income Statement
Years ended December 31

(in thousands of dollars)

	2024	2023	2022
Net sales	$ 3,980	$ 3,750	$ 3,400
Cost of sales	3,100	2,950	2,700
Gross profit	880	800	700
Selling, general and administrative expenses	640	590	510
Operating income	240	210	190
Interest expense	20	15	15
Loss on sale of equipment	5	-	4
Income before income taxes	215	195	171
Income tax expense	50	40	36
Net income	$ 165	$ 155	$ 135

See notes to the financial statements.

Real Example of an Income Statement

Below is an example of Amazon's consolidated statement of operations, or income statement, for the years ended December 31, 2015 – 2017. Take a look at the P&L and then read a breakdown of it below.

AMAZON.COM, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Year Ended December 31,		
	2015	2016	2017
Net product sales	$ 79,268	$ 94,665	$ 118,573
Net service sales	27,738	41,322	59,293
Total net sales	107,006	135,987	177,866
Operating expenses:			
Cost of sales	71,651	88,265	111,934
Fulfillment	13,410	17,619	25,249
Marketing	5,254	7,233	10,069
Technology and content	12,540	16,085	22,620
General and administrative	1,747	2,432	3,674
Other operating expense, net	171	167	214
Total operating expenses	104,773	131,801	173,760
Operating income	2,233	4,186	4,106
Interest income	50	100	202
Interest expense	(459)	(484)	(848)
Other income (expense), net	(256)	90	346
Total non-operating income (expense)	(665)	(294)	(300)
Income before income taxes	1,568	3,892	3,806
Provision for income taxes	(950)	(1,425)	(769)
Equity-method investment activity, net of tax	(22)	(96)	(4)
Net income	$ 596	$ 2,371	$ 3,033
Basic earnings per share	$ 1.28	$ 5.01	$ 6.32
Diluted earnings per share	$ 1.25	$ 4.90	$ 6.15
Weighted-average shares used in computation of earnings per share:			
Basic	467	474	480
Diluted	477	484	493

See accompanying notes to consolidated financial statements.

Who Uses Income Statement?

An income statement is invaluable in accounting, corporate finance, and for anyone who invests. It's also used internally so that a financial manager can forecast the company's financial performance (known as financial modeling), inform strategies, and propose operational changes to the executive team if needed.

Entrepreneurs thinking of starting their own business might look at the income statements of other businesses in their industry to see any potential pitfalls before they embark on their new venture. A small business owner, especially of a startup, will use quarterly—or even monthly—income statements to closely monitor the health of their fledgling enterprise. Having the most up-to-date information helps owners make informed, strategic decisions quickly and fix problems before they become expensive. With a highly detailed statement, it's possible to pinpoint every business-related expense to see where to carve out savings. This is essential intelligence for a new company on a tight budget**.**

Primary Purpose Of An Income Statement

To have a clear and accurate record of a company's profit and loss over periods of time is helpful for several reasons:

- **Tracks profitability** – Gives the owner, shareholders, and other stakeholders knowledge of where the company stands financially[2]
- **Aids in decision-making** – Increases owner awareness of the current financial status of the business; with accurate numbers, they can make faster and smarter decisions about new expenditures[2]
- **Helps ensure tax compliance** – Provides insight into the company's future tax liability (along with cash flow statement and balance sheet)
- **Tracks increases in the cost of goods (COG)** – Shows production or purchase expenses (as well as product returns) as a percentage of sales
- **Supports strategic planning** – Provides essential information to help business leaders plan for their organization's future by assessing its financial health, identifying growth opportunities, evaluating risk, allocating resources and monitoring progress[5]
- **Informs decisions regarding mergers and acquisitions** – "The income statement is the go-to document for potential acquirers when assessing a company's profitability. It lays bare whether a company is in the black or red financially and also provides insights into growth prospects – a crucial factor for those eyeing sustainable future returns."[6]

- **Strengthens the benchmarking process** – Business leaders can improve operating efficiency, build value and anticipate expected development in the marketplace[7]

Income statements are also used, in addition to balance sheets, by lenders (investors, banks, and vendors) to set credit limits when considering applications for business loans.

In short we can say that: an income statement is important for:

- strategic planning
- budgeting
- financial forecasts

You can use interim and annual income statements to:

- see how your business is performing through the year and at year-end
- quickly identify problem areas
- compare finances with targets, budgets and projections

The eight main components of an income statement

Here are the main elements in an income statement:

1. Revenue

Also known as sales, revenue is the amount of money a company has earned by selling its products and services over a period of time. The revenue amount includes only money made from core activities of the business.

For example, if a company manufactures industrial machines, its revenue would solely include earnings from that activity. It wouldn't include money earned from selling a building or financial investments. These are recorded elsewhere in the income statement.

2. Cost of goods sold, cost of sales or cost of services

Manufacturers refer to the cost of *goods* sold, which is the total cost associated with manufacturing a product. This amount includes raw materials and labour, along with amortization expenses.

By contrast, retailers and wholesalers refer to the cost of sales, which indicates how much the company spends on products purchased for resale.

Companies that offer services often refer to the cost of services.

This doesn't include costs related to administration, marketing, sales or distribution.

3. Gross profit

Gross profit is the difference between revenue and the cost of goods sold, sales or services.

It's calculated as follows:

GROSS PROFIT = REVENUE – COST OF GOODS SOLD (OR COST OF SALES/COST OF SERVICES)

Gross profit can be used to calculate the gross margin by dividing the gross profit by revenue and multiplying it by 100%, as shown in the example below:

$$\text{GROSS MARGIN} = \frac{\text{GROSS PROFIT X 100\%}}{\text{REVENUE}}$$

4. Operating expenses

Operating expenses (also called selling, general and administrative expenses, or SG&A) are the indirect costs of running the business. These may include:

- rent and utilities
- marketing and advertising
- insurance
- office supplies
- maintenance and repairs
- employee benefits
- accounting and legal fees
- property taxes

5. Operating income

Operating income is what's left over after operating expenses are subtracted from gross profit. It's calculated as follows:

Operating income = Gross profit – Operating expenses

6. Non-operating items

Non-operating items are gains and losses from non-core activities. Examples may include:

- interest
- dividends

- one-time items, such as asset sale earnings or relocation costs.

7. Earnings before taxes (EBT)

Earnings before taxes (also called income before taxes) is the amount of money left after all expenses and losses are subtracted from all revenue and gains. It's calculated as follows:

EBT = REVENUE – (INTEREST AND AMORTIZATION + NON-OPERATING ITEMS)

Earnings before taxes is a metric used to gauge a company's profitability before taxes. As companies pay taxes at different rates depending on their location, EBT is a better indicator of profitability than net income.

A company may also have discontinued operations, such as a product line, division or subsidiary that is discontinued. In that case, the company will use the term "earnings before taxes and discontinued operations." The discontinued operations will be presented separately, before net income.

8. Net income

Net income (also called net profit) is the amount left over after income taxes are subtracted from EBT. It's calculated as follows:

NET INCOME = EBT – INCOME TAXES

Net income is used to calculate the following indicators:

- Net profit margin: a widely used profitability indicator that can be benchmarked against industry peers
- Earnings before interest, taxes, depreciation and amortization

The Difference Between An Income Statement And A Balance Sheet

An income statement shows a company's revenue, expenditures and profitability over a period of time, usually a month, a quarter or a year. A balance sheet shows what a business owns and how much it owes at a specific point in time.

❖ TextBased Activities

Exercise 01: **True or False**

1. The income statement does not include non-operating expenses.
2. Small businesses do not require income statements to track profitability.
3. Revenue only includes earnings from a company's core activities.
4. Non-operating items such as interest and dividends are recorded separately.
5. Gross profit is determined before deducting operating expenses.
6. The balance sheet and income statement serve the same purpose.
7. Net income is the amount left after all expenses, including taxes, are deducted.

Exercise 02: Fill in the Blanks

1. The __________ statement provides a summary of a company's revenues and expenses over a specific period.
2. __________ expenses include costs such as rent, marketing, and employee benefits.
3. Gross profit is calculated by subtracting __________ from revenue.
4. __________ is the final amount remaining after income taxes are deducted from earnings before taxes.
5. The term __________ refers to gains and losses from activities that are not part of a company's core operations.
6. Earnings before taxes (EBT) is used to measure __________ before tax obligations are accounted for.
7. The __________ ratio is an indicator of profitability, calculated using net income and total revenue.

Exercise 03: Match the financial term to its correct definition.

1. Gross Profit
2. Operating Expenses
3. Earnings Before Taxes (EBT)
4. Non-operating Items
5. Net Income
6. Cost of Goods Sold
7. Revenue

A. Total sales from core business activities

B. Expenses such as rent, marketing, and utilities

C. Difference between revenue and cost of goods sold

D. Final profit after all expenses and taxes

E. Total cost of manufacturing or purchasing goods for resale

F. Profits before taxes are deducted

G. Gains and losses from activities outside the core business

Exercise 03: Short Answer Questions

1. What are the three key financial statements used to assess a company’s financial performance?
2. Why is an income statement also referred to as a profit and loss (P&L) statement?
3. How do entrepreneurs and small business owners use income statements?
4. Identify at least three primary purposes of an income statement.
5. Why is the income statement important for mergers and acquisitions?
6. How can an income statement help a business leader in strategic planning?
7. What is the significance of tracking the cost of goods sold in an income statement?