



Income Statement 101: The Basics

If you are like most business owners, the thought of analyzing financial statements and manipulating data in Excel spreadsheets makes you cringe. However, it is **critical** for you to understand your company's P&L (Profit & Loss; another term for Income Statement)!!! This financial statement tells you whether or not your business is profitable – and I'm willing to bet that turning a profit is one of the primary reasons you're in business! This article is meant for the business owner that's a true finance beginner – it defines what an income statement is, the key pieces of an income statement, and why it is essential for you to understand. By the end of this article, you should be able to better understand that monthly P&L that your bookkeeper hands over.

What is an Income Statement?

An income statement is a financial statement that shows your company's revenues, expenses, and profits over a certain period of time. For example, an income statement for the year 2016 would show your company's revenues, expenses, and profits during 2016. An income statement for Q1 2016 (1st quarter of 2016) would present those metrics for January, February, and March of 2016. You can prepare and analyze an income statement for any period of time, but monthly, quarterly and annual views are most common. While an income statement is only one of many financial statements that presents your company's financial performance, it is the most widely used.

Since this is a Finance 101 article, let's make sure we define all of the technical terms we are using before continuing:

Revenue: Also known as "sales" and "the top line". Your revenue is how much money you *bring in* from customers when selling your product or service. For a product based company, Revenue = (unit price X number of units sold). For example, let's say you sell widgets. If you sell each widget for \$10 and you sell 20,000 widgets during 2016, then your revenue for 2016 equals \$10 X 20,000, or \$200,000. For a subscription-based company (i.e. Software as a Service a.k.a. SAAS), Revenue = (price of the subscription X number of subscriptions people have purchased). For example, let's say you sell a subscription-based

software like Quickbooks. If you charge customers an annual subscription fee of \$100, and you have 500 customers during 2016, your revenue for 2016 equals \$100 x 500, or \$50,000.

Expense: Also known as “cost”. Expenses are the costs of running your business – money outflows to pay for the things you need to operate your business. Some examples are raw materials, employee salaries, rent, utilities, marketing, advertising, consulting, taxes, etc. Literally any cost associated with running your business is considered a business expense. For example, if the company producing widgets spends \$70,000 on raw materials, \$30,000 to pay its employees, \$10,000 on advertising, \$20,000 on factory rent, and \$20,000 on taxes, the company’s total expenses would be the sum of those things, or \$150,000. Expenses are generally broken down into two categories: Cost of Goods Sold (COGS) and Operating Expenses. COGS are costs directly related to producing your product or selling your service (for example, raw materials and labor required to build your product). Operating expenses are costs that are incurred regardless of the number of goods or services you sell (for example, rent, advertising, and telephone).

Profit: Also known as “net income” or “the bottom line”. Profit is the actual money you are making – the money left over once you’ve sold your goods and paid your bills. Profit equals Revenue minus Expenses. For example, if you are the widget business owner mentioned above and you have \$200,000 in revenue and \$150,000 in expenses, your profit would be (\$200,000 - \$150,000), or \$50,000.

What are the Key Components of an Income Statement?

The key components of an income statement are those mentioned directly above – *revenue*, *expense*, and *profit*.

What Does an Income Statement Look Like?

Pictured below is a very basic income statement:

Revenue	100
Cost of Goods Sold	<u>(50)</u>
Gross Margin	50
Operating Expenses	<u>(20)</u>
Net Income	<u>30</u>

At the very end of this article, there is an example of a more detailed income statement.

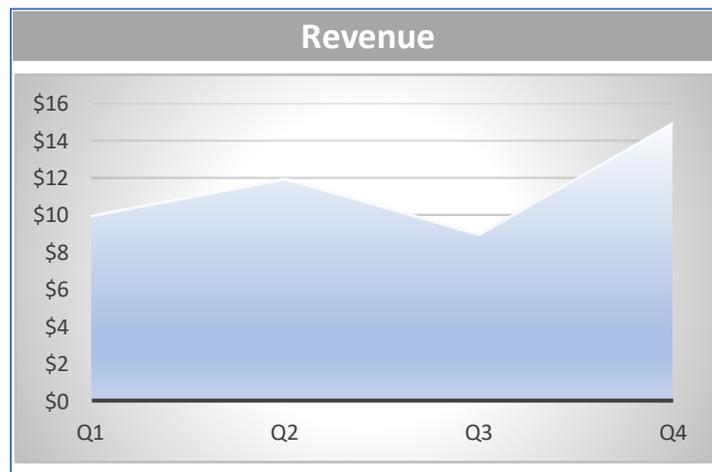
How Can an Income Statement be Useful to Me?

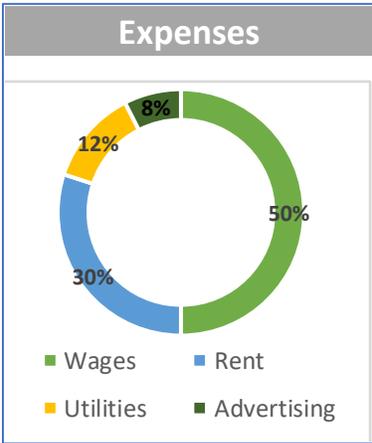
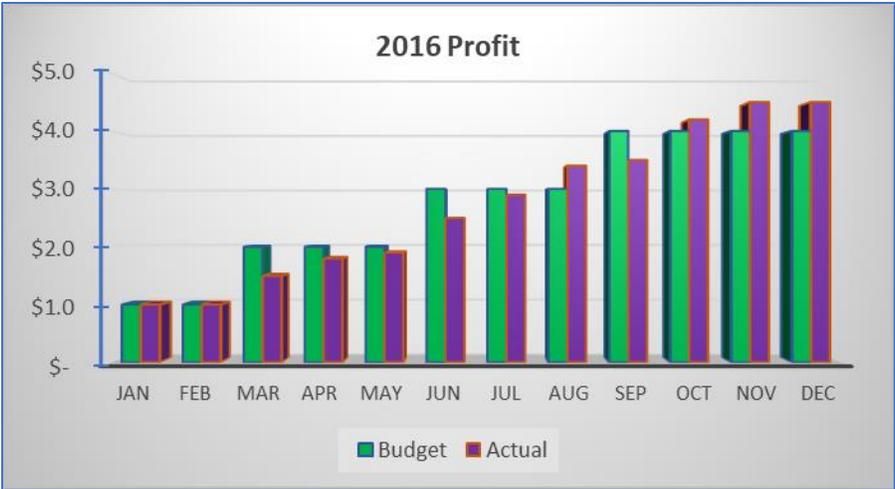
An income statement shows you how your business performed over a certain period of time. By looking at income statements over time, you can identify trends in your performance. Perhaps more importantly, you can identify areas where you might be able to make money and/or save money.

The metrics included in an income statement can help you calculate your costs and profits as a percentage of sales. You can also calculate a myriad of other useful and informative ratios from an income statement.

Finally, having a solid understanding of what drives your sales and expenses will arm you with the information you need to make important business decisions and projections about the future. Projections (also known as pro forma financials) serve a critical purpose in running a business – they provide you with a roadmap, or operating plan, by which to run your business and measure your performance against.

Key Metric Examples From Income Statement Data





Detailed Income Statement Example

	Apr-17		
	Plan	Actual	Variance
Revenue			
Product 1	1,030	2,000	970
Product 2	4,120	5,000	880
Product 3	9,270	10,000	730
Product 4	16,480	16,000	(480)
Product 5	25,750	25,000	(750)
Product 6	37,080	30,000	(7,080)
Other	50,470	45,000	(5,470)
Total Revenue	\$ 144,200	\$ 133,000	\$ (11,200)
Cost of Goods Sold			
Product 1	515	500	(15)
Product 2	2,060	2,000	(60)
Product 3	4,635	4,000	(635)
Product 4	8,240	8,000	(240)
Product 5	12,875	12,000	(875)
Product 6	18,540	15,000	(3,540)
Other	25,235	20,000	(5,235)
Total Cost of Goods Sold	\$ 72,100	\$ 61,500	\$ (10,600)
Gross Margin	\$ 72,100	\$ 71,500	\$ (600)
Operating Expenses			
Salaries & benefits	33,744	30,000	(3,744)
Advertising	15,300	16,000	700
Credit card fees	2,884	2,300	(584)
Repairs & Maintenance	5,000	4,000	(1,000)
Professional Services	5,000	6,000	1,000
Insurance	1,000	1,000	-
Travel, Meals and Entertainment	800	1,000	200
Rent	1,200	1,200	-
Software Subscriptions	500	450	(50)
Office Expenses	800	500	(300)
Dues/Subscriptions	-	200	200
Minor Equipment	-	300	300
Sponsorship / Donations	-	100	100
Telephone/Internet	500	650	150
Utilities	1,000	1,200	200
Other Expenses	2,800	3,200	400
Total Operating Expenses	\$ 70,528	\$ 68,100	\$ (2,428)
Operating Profit (Before Other Expenses)	\$ 1,572	\$ 3,400	\$ 1,828
Other Expenses			
Amortization	833	833	(0)
Depreciation	3,125	3,125	-
Interest:			
Commercial Loan	478	500	22
SBA Loan	895	900	5
Other Loan(s)	-	-	-
Bad Debt Expense	-	-	-
Total Other Expenses	5,332	5,358	26
Net Income Before Income Tax	\$ (3,761)	\$ (1,958)	\$ 1,803
Income Tax	-	-	-
Net Profit/Loss	\$ (3,761)	\$ (1,958)	\$ 1,803