

Accounting 101: How to Read an Income Statement

Your income statement is one of the most important documents your company produces. However, if you are the owner of a new business, or if you aren't familiar with this type of statement, preparing and interpreting it can be challenging. To read your income statement accurately, consult the information below.

What is an Income Statement?

An income statement, which may also be referred to as a "profit and loss statement," is an important financial report that communicates your business's ability to earn a profit. This statement includes information about the money that came into your company during a given period, the expenses your company incurred during that period, and the total amount of profit you earned after all expenses were paid. If your expenses during this time exceeded the amount of income you earned, your income statement will show a loss for the period.

Sections of an Income Statement

In most cases, your income statement will be divided into various sections, including Revenue, Operating Expenses and Taxes. Within each section, smaller subsections exist to provide more detailed information. The final line on the statement provides your net profit or loss, which is calculated as the difference between your revenue and all of the expenses paid to earn that revenue.

Not every income statement includes the same information. However, most statements will include the following lines:

- **Heading** – At the top of the statement, you will find a heading that provides the name of your company and the period of time the statement covers.
- **Revenue** – The "Revenue" subheading begins the section of the statement that provides details about revenue earned during the period.
- **Gross Sales** – This line of the statement tells you the value of all sales made during the period before any deductions for expenses.
- **Returns and Allowances** – Returns and Allowances include the cost of any goods returned by customers or discounted by your company.
- **Net Sales** – Net Sales is calculated by subtracting the value of Returns and Allowances from your Gross Sales.
- **Cost of Goods Sold** – This line lists the total wholesale cost of all of the goods you sold during the period.
- **Gross Profit** – Gross Profit is calculated by deducting the Cost of Goods Sold from Net Sales.
- **Operating Expenses** – The Operating Expenses subheading begins the section of the income statement that includes all of the expenses your company paid to operate during the period in question.
- **Sales and Marketing** – Beneath the Operating Expenses subheading, you will find a smaller subheading labeled "Sales and Marketing." In this section, you will find a list

of all of the expenses your company incurred in relation to marketing. Examples include advertising, commissions and direct marketing. At the bottom of this section, you will find a total of these expenses.

- **General Administrative** – This section of the document includes all of the administrative expenses paid during the period, including office supplies, utilities and more. At the end of this section, all general administrative expenses are totaled.
- **Depreciation and Amortization** – Under this heading, any expensive assets your business is currently depreciating will be listed, along with the total amount of depreciation for the period.
- **Total Operating Expenses** – This section of the income statement provides the total of your operating expenses for the period, including depreciation, administrative expenses and advertising expenses.
- **Operating Income** – Your Operating Income is the amount of income left over after all of your operating expenses are deducted from your gross profit.
- **Nonoperating Income** – This section includes all of the income you earned outside of your standard operations, such as by the sale of assets or investments.
- **Nonoperating Expenses** – Nonoperating expenses include expenses you paid that were not related to the operations of your business. These expenses may be related to earning nonoperating income.
- **Income before Taxes** – The value on this line is calculated by adding your Operating Income and Nonoperating Income and then subtracting your Nonoperating Expenses.
- **Taxes** – This section includes all of the taxes your business paid during the period, including prepaid income tax and payroll taxes.
- **Total Net Income** – The final line on your income statement is your total net income. It is calculated by subtracting your total Taxes from Income before Taxes. If your expenses for the period exceeded your income, this value will be negative, representing an overall loss.

In some cases, an income statement will have more than one column so that you can compare income and expenses from different periods.

Getting Professional Help

Preparing an income statement is no easy task, and interpreting it can also be taxing for many business owners. However, you can dramatically simplify this process by allowing an accounting professional to help you with your income statement and the other financial reports your business produces. A reputable accounting professional will not only ensure that your income statement is accurate, but the professional will also be able to help you gain important insight from these statements that can be used to boost your business's profitability in the future.